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In the Supreme Court of the United States

OCTOBER TERM, 1981

T. H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

STATE OF NEW JERSEY

T. H. BELL, SECRETARY OF EDUCATION, PETITIONER

v.

COMMONWEALTH OF PENNSYLVANIA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Whether, in the absence of specific statutory authority, federal agencies may require recipients of grant-in-aid funds to repay amounts that have been determined, after an administrative hearing, to have been misspent.

2. If not, whether there is sufficient statutory authority to permit such recoupment of improper expenditures under Title I of the Elementary and Secondary Education Act of 1965.

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COMMONWEALTH OF PENNSYLVANIA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of T. H. Bell, Secretary of Education, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-26a) is reported at 662 F.2d 208. The decisions of the Education Appeal Board (Apps. D and E, *infra*, 31a-87a) are not reported.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 27a-28a) was entered on October 13, 1981, and a petition for rehearing was denied on December 17, 1981 (App. C, *infra*, 29a-30a). On March 8, 1982, Justice Brennan extended the time for filing a petition for a writ of certiorari to April 16, 1982, and on April 6, 1982, he further extended the time for filing a petition to and including May 16, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

20 U.S.C. (Supp. IV) 1226a-1 [1] provides:

> Payments pursuant to grants or contracts under any applicable program may be made in installments, and in advance or by way of reimbursement, with necessary adjustments on account of overpayments or underpayments, as the Secretary may determine.

20 U.S.C. (Supp. IV) 1234a provides in pertinent part:

> (a) Final audit determination; written notice to State or local educational agency
>
> Whenever the Secretary determines that an expenditure not allowable under a program listed in section 1232d(a) of this title, or conducted under title VI and title VII of the Elementary and Secondary Education Act of 1965 [20 U.S.C. 1391 et seq., 3221 et seq.] or under the Emergency School Aid Act [20 U.S.C. 3191 et seq.] has been made by a State or by a local educa-

[1] The same provision originally appeared in 20 U.S.C. (1976 ed.) 1232d.

tional agency, or that a State or local educational agency has otherwise failed to discharge its obligation to account for funds under any such program, the Secretary shall give such State or local educational agency written notice of a final audit determination, and he shall at the same time notify such State or agency of its right to have such determination reviewed by the Board.

(b) Application for review; * * *

A State or a local educational agency that has received written notice of a final audit determination and that desires to have such determination reviewed by the Board shall submit to the Board an application for review not later than thirty days after receipt of notification of the final audit determination. * * * Unless the Board determines that a final audit determination lacks sufficient detail, the burden shall be upon the State or local educational agency to demonstrate the allowability of expenditures disallowed in the final audit determination.

(c) Collection of amount owing to await final decision

When a State or a local educational agency has submitted an application for review with respect to a final audit determination, no action shall be taken by the Secretary to collect the amount determined to be owing until the Board has issued a final decision upholding the audit determination as to all or any part of such amount. * * *

(d) Finality

A decision of the Board with respect to an application for review under this section shall be-

come final unless within sixty days following receipt by the State or by the local educational agency of written notice of the decision—

(1) the Secretary for good cause shown, modifies or sets aside the decision, in whole or in part, in which case the decision shall become final sixty days after such action by the Secretary, or

(2) the State or the local educational agency files a petition for judicial review as provided in section 1234d of this title.

(e) Establishment of amount owing

A final audit determination by the Secretary under subsection (a) of this section with respect to which review has not been requested pursuant to subsection (b) of this section, or a final decision of the Board under this section upholding a final audit determination against a State or local educational agency shall establish the amount of the audit determination as a claim of the United States which the State or the local educational agency shall be required to pay to the United States and which may be collected by the Secretary in accordance with the Federal Claims Collection Act of 1966 [31 U.S.C. 951 et seq.].

* * * * *

(g) Five-year limitation period

No State and no local educational agency shall be liable to refund any amount expended under an applicable program which is determined to be unauthorized by law if that expenditure was made more than five years before that State or local educational agency is given the notice required by subsection (a) of this section.

20 U.S.C. (Supp. IV) 2835 provides:

(a) Auditing

The Office of Inspector General of the Department of Education shall make provision for audits of grants made under this subchapter to determine, at a minimum, the fiscal integrity of grant or subgrant financial transactions and reports, and the compliance with applicable statutes, regulations, and terms and conditions of the grant or subgrant.

(b) Audit resolution and repayment

The Secretary shall adopt procedures to assure timely and appropriate resolution of audit findings and recommendations arising out of audits provided for in subsection (a) of this section. Such procedures shall include timetables for each step of the audit resolution process and an audit appeals process. Where, under such procedures, the audit resolution process requires the repayment of Federal funds which were misspent or misapplied, the Secretary shall require the repayment of the amount of funds under this subchapter which have been finally determined through the audit resolution process to have been misspent or misapplied. Such repayment may be made from funds derived from non-Federal sources or from Federal funds no accountability for which is required to the Federal Government. Such repayments may be made in either a single payment or in installment payments over a period not to exceed three years.

STATEMENT

1. Title I of the Elementary and Secondary Education Act of 1965, 20 U.S.C. (Supp. IV) 2701 *et*

seq.[2] was enacted to provide federal funding to expand and improve programs "which contribute particularly to meeting the special educational needs of educationally deprived children" in areas where there are high concentrations of children from low-income families. 20 U.S.C. (Supp. IV) 2701. The Secretary of Education (the Secretary) acting through state educational agencies (SEAs), distributes funds to local educational agencies (LEAs) to provide services to eligible educationally deprived children. The statutory scheme is carefully constructed to ensure that the funds appropriated are actually expended for the benefit of disadvantaged school-children. Only schools, attendance areas and children meeting very specific statutory criteria are entitled to Title I funds (20 U.S.C. (Supp. IV) 2732, 2733, 2736, 2737).

In order to participate in the Title I program, an SEA must submit assurances to the Secretary that the program will be administered in accordance with all applicable statutes and regulations. 20 U.S.C. (Supp. IV) 1232d, 2802. For the LEA to obtain Title I funds, it must submit a written application to its SEA proposing a project to meet the special educational needs of educationally deprived children. 20 U.S.C. (Supp. IV) 1232e, 2731, 2734. The amount of funds that an LEA may receive under Title I is determined by a formula based on the number of children from low-income families in the

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[2] Title I has been repeatedly and extensively revised since its original enactment (App. A, *infra*, 2a n.2). Similar provisions to the ones summarized in this paragraph have been included in the statute since its inception, although only the current citations are provided.

area served by the LEA and the state per pupil expenditure. 20 U.S.C. (Supp. IV) 2711.

Grant payments may be made either in advance or by way of reimbursement. 20 U.S.C. (Supp. IV) 1226a-1, 2841. Department of Education regulations provide four specific methods of payment: "[a]dvance by Treasury check," "[r]eimbursement by Treasury check," percentage of completion method (for construction work), or letter of credit. 34 C.F.R. 74.91, 74.93. The letter of credit is the preferred method of payment. Pursuant thereto the Department authorizes the grantee to draw funds from the Treasury during the fiscal year, generally not less frequently than monthly, based upon grantee projections of the cost of providing the identified services for that period. 34 C.F.R. 74.61(e), 74.92.

Each state must conduct audits to determine whether the federal Title I monies were lawfully and properly applied. 20 U.S.C. (Supp. IV) 2817. In addition, the Secretary may conduct an audit at any time (5 U.S.C. (Supp. IV) App. 378-383; 20 U.S.C. (Supp. IV) 2835).[3] If, as a result of either type of audit, the Secretary determines that grantee fund withdrawals have exceeded the amount to which the grantee was entitled, or that funds have been misspent, a demand is made for restoration. If the grantee is unable or unwilling to pay the debt, the Secretary may offset the amount of the unauthorized payments against current or prospective grant disbursements in order to recoup the excess payments, but only if the offset does not impair the current operation of the program (34 C.F.R. 74.95(a)).

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[3] This authority was originally contained in 20 U.S.C. (1976 ed.) 1232c(a)(2).

2. Respondents, the State of New Jersey and the Commonwealth of Pennsylvania, participate as grantees in the Title I program. In the early 1970's the Department of Health, Education, and Welfare Audit Agency (HEWAA) performed separate audits of their programs for Fiscal Years 1971-1973 (New Jersey) and 1968-1973 (Pennsylvania). In its final audit reports, issued in 1975, HEWAA found that both States had misapplied substantial sums of federal Title I monies during the periods under investigation (C.A. App. 1a (N.J.); C.A. App. 17a (Pa.)).[4] After soliciting responses from the States, the Deputy Commissioner for Elementary and Secondary Education in the Office of Education (now, the Department of Education) issued final determination letters sustaining the audit findings and ordering the States to refund the amounts determined to have been misspent (C.A. App. 44a (N.J.); C.A. App. 81a (Pa.)).

Both States filed applications for review with the Title I Audit Hearing Board (C.A. App. 50a (N.J.); C.A. App. 91a (Pa.)).[5] After hearings, the successor Education Appeal Board in February 1980 concluded that New Jersey "should make * * * payment [totaling $1,031,304] to the U.S. Office of Edu-

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[4] "C.A. App." refers to the separate Appendix for each State filed in the court of appeals.

[5] The Title I Audit Hearing Board was administratively established in 1972 to provide SEAs with an opportunity to appeal audit findings to an impartial administrative tribunal. 37 Fed. Reg. 23002-23003 (1972). Effective June 29, 1979, the Title I Audit Hearing Board was replaced by the statutorily mandated Education Appeal Board and that Board assumed jurisdiction over the appeals filed by New Jersey and Pennsylvania. See 44 Fed. Reg. 30528-30537 (1979), 44 Fed. Reg. 43807 (1979).

cation" (App. D, *infra*, 57a); in May 1980 it similarly concluded that Pennsylvania should submit payment in the amount of $422,424.29 to the Department of Education (App. E, *infra*, 86a). The Secretary declined to review the decisions and accordingly, after the period for comment and review, the Board's decisions became the final decisions of the Department (App. F, *infra*, 88a-91a). Each State was informed that appropriate officials "will be in touch with you at an early date to discuss the method of repayment" (App. F, *infra*, 88a, 90a).[6]

3. Respondents thereupon filed separate petitions for review in the United States Court of Appeals for the Third Circuit contending, *inter alia*, that the Secretary lacked both statutory authority and a common law right to administratively recoup illegally expended pre-1978 Title I funds.

The court of appeals agreed; on the basis of a consolidated decision, it granted the petitions and remanded to the agency with instructions to vacate the orders requiring payment (App. A, *infra*, 1a-26a). First, the court found (App. A, *infra*, 12a-14a) that the Department of Education lacked specific statutory authority to order the repayment of these misspent funds because the only express authorization to recoup was provided in the 1978 amendments to Title I (20 U.S.C. (Supp. IV) 2835(b); see also 20 U.S.C. (Supp. IV) 1234a(e)). Relying on the "overarching principle" of *Pennhurst State School* v. *Halderman*, 451 U.S. 1 (1981)—that "the terms and conditions of a federal grant must be set forth clearly

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[6] No such discussions have yet taken place. Collection in accordance with the Federal Claims Collection Regulations (4 C.F.R. Part 102) has been postponed pending the outcome of this litigation. See 20 U.S.C. (Supp. IV) 1234a(e).

and unambiguously in the statute authorizing the grant"—the court held that the 1978 statute could not be applied retroactively to funds misspent prior to the effective date thereof (App. A, *infra*, 14a).

Second, although recognizing that the government may resort to the same common law remedies—including setoffs—as private contractors, the court stated (without deciding the issue) that these remedies may not survive where a statutory remedy is provided (App. A, *infra*, 21a). But, the court concluded, even if such a common law remedy survived here, the "advance-funding" method of distributing money "lends itself to enforcement of that right only by an action in a court of competent jurisdiction." (*ibid.*). The court accordingly distinguished this case from *Mt. Sinai Hospital* v. *Weinberger*, 517 F.2d 329 (5th Cir. 1975), cert. denied, 425 U.S. 935 (1976), which upheld the common law right of the Department of Health, Education, and Welfare to recover unauthorized Medicare payments by setoff. The court below explained that the use of an "offset" in a reimbursement program such as Medicare would not prejudice the intended beneficiaries of the program, whereas employment of a setoff in an advance-funded program such as Title I would have such an effect and was therefore proscribed (App. A, *infra*, 21a-22a). Thus, the court concluded, agencies administering advance-funded grants cannot administratively enforce a common law right of setoff, even if such a right exists (*id.* at 24a-25a).

REASONS FOR GRANTING THE PETITION

1. The decision below is in direct conflict with the decision of the Fourth Circuit in *State of West Virginia* v. *Secretary of Education*, 667 F.2d 417

(1981), which held that the Secretary has both statutory and common law authority to recover misspent Title I funds on the basis of audits and Board hearings procedurally identical to those involved here, even though the funds were received by the State prior to the effective date of the Education Amendments of 1978 (667 F.2d at 419).[7] There are 27 other Title I cases now pending before the Board, involving audit claims of more than $60 million in funds received by states before the effective date of the 1978 amendments. Extensive proceedings have already been held in a number of these cases; several are awaiting Board decision.[8] Unless the circuit conflict is resolved, and the decision below reversed, the Secretary must either undertake the expensive, time-consuming, and duplicative effort of pursuing these claims in a number of district courts despite the favorable ruling of the Fourth Circuit,[9] or he must face further delays in his attempts to recoup the funds on the basis of the Board hearings, while other states, relying on the decision below, challenge his authority in courts of appeals that have not spoken on the

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[7] On April 26, 1982, this Court denied West Virginia's motion to direct the Clerk of the Court to file an untimely petition for certiorari seeking review of the Fourth Circuit's decision.

[8] The Secretary has recently reached final decisions in two other such Title I audit cases that were before the Board. Under 20 U.S.C. (Supp. IV) 1234d, the States of Kentucky and Oklahoma may appeal these decisions to the United States Courts of Appeals for the Sixth and Tenth Circuits, respectively. Both of these States raised the instant decision as a defense in the administrative proceedings.

[9] Some of the recoupment claims might now be barred by the statute of limitations. Compare 20 U.S.C. (Supp. IV) 1234a(g) with 28 U.S.C. 2415.

issue. Only a prompt decision by this Court can avoid the inevitable expense, delay, and administrative confusion created by this conflict.

2. The disruptive effects of the decision below can be expected to extend beyond Title I. In reaching its decision, the court of appeals focused on the legislative scheme of Title I (App. A, *infra*, 3a-8a) and apparently concluded that the implication of a right to administrative recoupment of funds dispersed before the 1978 amendments became effective was inconsistent with the other enforcement provisions contained in the statute (see, *e.g.*, *id.* at 7a, 20a). But the vast majority of federal statutes providing for advance-funded grants do not specifically authorize administrative recoupment. See R. Cappalli, *Rights and Remedies Under Federal Grants* 98 (1979); 31 C.F.R. 205.4, 205.7. Many of these statutes contain equally detailed enforcement provisions. Moreover, the language of the court's conclusion (App. A, *infra*, 24a-25a) at least suggests that it believed it was establishing a general principle for the interpretation of statutes authorizing federal grants. The decision below thus inevitably casts doubt on the validity of the recoupment procedures of many federal agencies. That doubt in itself threatens those agencies with the same sorts of expenses, delay and confusion now facing the Department of Education.[10]

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[10] Indeed, recipients of grants from other federal agencies have already relied on the decision below in challenging recoupment efforts of those agencies. For example, the Department of Labor has informed us that grantees are relying on the instant decision in challenges to recoupment efforts under the Comprehensive Employment and Training Act of 1973, 29 U.S.C. 801 *et seq.*, and the Environmental Protection Agency reports similar problems.

The court of appeals' decision thus undercuts the effectiveness of a principal method of controlling unauthorized expenditures under the approximately one thousand federal assistance programs funded primarily through grants, and jeopardizes efforts by the federal government to recover millions of dollars used under grant statutes in ways that do not further the purposes for which those statutes were enacted. In sum, while this Court has "long recognized that Congress may fix the terms on which it shall disburse federal money to the States" (*Pennhurst State School* v. *Halderman*, 451 U.S. 1, 17 (1981); see also *King* v. *Smith*, 392 U.S. 309, 333 n.34 (1968); *Oklahoma* v. *U.S. Civil Service Commission*, 330 U.S. 127, 143 (1947)), the decision below seriously weakens the federal government's ability to enforce those terms.

The enforcement problem is a serious one. In fiscal year 1981 alone, federal grants-in-aid to state and local governments exceeded $95 billion; as of June 30, 1981, at least $374 million of audit-related debts were outstanding. Comptroller General, *Federal Agencies Negligent in Collecting Debts Arising From Audits* 2, 6 (1982) ("GAO Report"). Both Congress and the President have recently expressed concern about deficiencies in agency efforts to collect these audit disallowances. GAO Report; United States Executive Office of the President, Office of Management and Budget, *Major Themes and Additional Budget Details, Fiscal Year 1983*, 279-283. Contrary to the suggestion of the court of appeals (App. A, *infra*, 23a), the right to "maintain[] a civil action in a court of competent jurisdiction" is not an adequate alternative.[11] The sheer volume of

[11] Of course, to the extent that the court below suggested that no common law right to recover the misapplied sums

such suits would, as a practical matter, seriously strain both judicial and administrative resources, and the large sums of money involved often would encourage grant recipients to resist repayment, thereby postponing the need to repay the sums in dispute. Moreover, administrative agencies or independent administrative boards such as the Education Appeal Board, which have special expertise in the area involved, are better suited to resolve the issues likely to arise in challenges to audit claims.

3. These severe adverse effects are the result of the court of appeals' misinterpretation of controlling legal principles.

This Court has established that the federal government has inherent authority to recover funds illegally paid. See, *e.g.*, *United States* v. *Carr*, 132 U.S. 644 (1890); *Wisconsin Central R.R.* v. *United States*, 164 U.S. 190 (1896). This right may be exercised by appropriate and reasonable means, including deducting or withholding the amount of the overpayment from other sums due to the recipient. See *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239-240 (1947); *Gratiot* v. *United States*, 40 U.S. (15 Pet.) 336 (1841); *McKnight* v. *United States*, 98 U.S. 179, 186 (1878); *Wisconsin Central R.R.* v. *United States*, *supra*. The right of recoupment is independent of statute. See *United States* v. *Wurts*, 303 U.S. 414, 416 (1938); *Grand Trunk Western Ry.* v. *United States*, 252 U.S. 112, 121

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exists even in a judicial proceeding (App. A, *infra*, 23a), the problem would be exacerbated. For example, if the Secretary cannot even recover misspent pre-1978 Title I funds by instituting an action in federal court, the federal government would have no recourse once it determines that a state has misspent the funds, regardless of how egregiously the conditions of the grant have been violated.

(1920); *United States* v. *Bank of the Metropolis*, 40 U.S. (15 Pet.) 377, 401 (1841). It is abrogated only where Congress has clearly manifested its intention to do so. *United States* v. *Wurts*, *supra*, 303 U.S. at 416. Nowhere in Title I or elsewhere is there any explicit pronouncement of congressional intent to raise a statutory barrier to recoupment;[12] hence, the United States clearly retains its common law right of recoupment to recover misspent funds.[13]

Other courts of appeals have consistently affirmed the common law right of an agency to recoup administratively without resort to court action. See, *e.g.*, *Collins* v. *Donovan*, 661 F.2d 705, 708 (8th Cir. 1981); *Jacquet* v. *Westerfield*, 569 F.2d 1339, 1342 (5th Cir. 1978); *Mt. Sinai Hospital* v. *Weinberger*, 517 F.2d 329 (5th Cir. 1975), cert. denied, 425 U.S. 935 (1976). Cf. *Burlington Northern, Inc.* v. *United*

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[12] Instead, the 1974 enactment of a statute of limitations for the recovery of audit claims (20 U.S.C. (1976 ed.) 884), and the legislative history of Title I both indicate that Congress has always expected the Secretary to recover Title I funds administratively determined to have been misused. See S. Rep. No. 91-634, 91st Cong., 2d Sess. 83-84 (1970); H.R. Rep. No. 93-805, 93d Cong., 2d Sess. 78-79 (1974).

[13] The court below suggested that the common law right may have been abrogated because Title I expressly authorizes the agency to withhold funds and disapprove grant applications. App. A, *infra*, 20a, 23a. The fact that a statute provides for one remedy falls far short of constituting the required explicit pronouncement of congressional intent to repeal the recoupment remedy. *United States* v. *Wurts*, *supra*. In providing explicit statutory recoupment authority in the 1978 amendments, Congress simply provided a procedural framework for the administrative enforcement of rights otherwise implicitly held.

States, 462 F.2d 526, 529 (Ct. Cl. 1972); *Lodge 2424, International Association of Machinists & Aerospace Workers* v. *United States*, 564 F.2d 66, 71 (Ct. Cl. 1977); *Transwestern Pipeline Co.* v. *United States*, 639 F.2d 679, 687 (Ct. Cl. 1980). The court below incorrectly distinguished cases such as *Mt. Sinai Hospital* v. *Weinberger*, *supra*, on the ground that they involved reimbursement funding. The court believed that, in such circumstances, recovery of unauthorized payments by offset would not injure the intended beneficiaries of the federal programs (*e.g.*, Medicare) involved, whereas an offset in the advance-funded Title I programs would injure the disadvantaged children that are its intended beneficiaries (App. A, *infra*, 21a-22a). But recoupment authority should not turn on the Secretary's choice among alternative available funding methods (20 U.S.C. (Supp. IV) 1226a-1); 20 U.S.C. (1976 ed.) 1232d). In any event, the distinction between "advance" and "reimbursement" funding is not significant. Actual payments under both Medicare and Title I, for example, are disbursed in similar fashion—at periodic intervals, generally monthly, throughout the fiscal year—and payments may be withheld at any time during the year for good cause. See page 7, *supra*; *Mt. Sinai Hospital* v. *Weinberger*, *supra*, 517 F.2d at 335.

Moreover, contrary to the decision below, Title I programs would not be impaired by a properly effectuated offset.[14] Department regulations prohibit the collection of a debt by reduction of future payments if the reduction would impair the accomplish-

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[14] Nor is it clear that Medicare beneficiaries would continue to receive treatment to the same extent if an offset were implemented. See *Mt. Sinai Hospital* v. *Weinberger*, 376 F. Supp. 1099, 1104 (S.D. Fla. 1974).

ment of the objectives of the grant program (34 C.F.R. 74.95(a)). Instead, debtor states must be required to replenish offset funds out of state and local funds, or out of federal funds for which there is no accountability to the federal government. Payment may be made by check or by offset procedures requiring the grantee to agree to perform fully the grant despite reduced Title I payments. See 34 C.F.R. 74.95(a); 45 Fed. Reg. 21303-21306 (1980); GAO Report, *supra*, at 26-28. Furthermore, since the amount of a state's misspent funds is generally small compared to a state's Title I allocation, and Title I is financed entirely by federal funds, there is virtually no risk of total program frustration through grantee withdrawal. Indeed, although the Department of Education's authority to recoup has been undisputed since enactment of the 1978 amendments, no state has elected to withdraw from the program, nor have the program's goals been impaired in any way.

While impact on program goals and beneficiaries is a valid consideration in determining the method of repayment, such determination rests within the broad discretion of the agency, subject to judicial review for arbitrariness. The Secretary has not yet had the opportunity to exercise that discretion here. As the notice letter to each State indicated (App. F, *infra*, 88a, 90a), the "method of repayment of the funds in question" remains to be determined after judicial review is completed and the amount of the State's liability established. At this stage of the proceedings, therefore, it was inappropriate for the court to assume that the Secretary will select a collection method that is inconsistent with the statutory purposes.

Finally, even if express statutory authority for administrative recoupment is necessary, Title I has contained such authority since the 1978 amendments, substantially before the completion of the Board proceedings involved here.[15] Contrary to the conclusion of the court of appeals, reliance on the authority contained in the 1978 amendments (20 U.S.C. (Supp. IV) 2835, 1234a(e)) does not involve an unfair retroactive application of the law. Compare *State of West Virginia* v. *Secretary of Education*, *supra*, 667 F.2d at 419. It is well established that the federal courts and administrative agencies should apply the law in existence at the time of decision unless doing so would result in manifest injustice. See *Gulf Offshore Co.* v. *Mobil Oil Corp.*, No. 80-590 (July 1, 1981) slip op. 12 n.16; *Bradley* v. *Richmond School Board*, 416 U.S. 696, 711 (1974); *United States* v. *Schooner Peggy*, 5 U.S. (1 Cranch) 103, 110 (1801). States do not have a vested right to any particular procedure for litigating Title I audit claims, and they certainly did not have a vested right to misspend Title I funds. Recoupment by administrative en-

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[15] See also 31 U.S.C. 952(a), the Federal Claims Collection Act of 1966, which requires the head of each federal agency to "attempt collection of all claims of the United States for money or property arising out of the activities of, or referred to, his agency." Pursuant thereto, government-wide regulations promulgated jointly by the Attorney General and the Comptroller General (4 C.F.R. Parts 101-105 (1980)) obligate the head of each agency to take "aggressive" and "timely" action to collect debts, including making "written demands * * * upon a debtor" and instituting an "offset * * * in every instance in which this is feasible," so long as the claims are certain in amount. See 4 C.F.R. 102.1, 102.2, 102.3.

forcement, subject to judicial review, would not work a manifest injustice.[16]

Nothing in this Court's decision in *Pennhurst State School* v. *Halderman*, 451 U.S. 1 (1981), suggests otherwise. Although the Court there emphasized that "if Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously" (*id.* at 17), the Secretary here is simply attempting to recover funds spent in violation of unambiguously expressed conditions. There is no attempt to saddle the states with financial obligations that they could not have anticipated when they accepted the grants. All that is at issue is their obligation to account to the Secretary for the expenditure of the funds pursuant to the conditions to which they agreed, and when it has been administratively determined that they cannot do so, to repay the funds to which they were not entitled. Imposing such an obligation on the states is hardly unfair to them; to the contrary, permitting the states to retain the large sums of misspent funds is unfair to the intended beneficiaries of the federal funds and to the taxpayers whose monies have been diverted from their intended purposes.

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[16] Even assuming that reliance on 20 U.S.C. (Supp. IV) 2835 to recoup previously misspent funds involved a retroactive application of that section, it is generally recognized that "statutory changes that are procedural or remedial in nature apply retroactively." *United States* v. *Vanella*, 619 F.2d 384, 386 (5th Cir. 1980); see *Koger* v. *Ball*, 497 F.2d 702, 706 (4th Cir. 1974); *United States* v. *Haughton*, 413 F.2d 736, 738 (9th Cir. 1969).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1982

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 80-1991
No. 80-2302

STATE OF NEW JERSEY,
DEPARTMENT OF EDUCATION,
PETITIONER IN No. 80-1991

v.

SHIRLEY HUFSTEDLER,
SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT OF EDUCATION,
RESPONDENT IN No. 80-1991

COMMONWEALTH OF PENNSYLVANIA,
PETITIONER IN No. 80-2302

v.

SECRETARY OF EDUCATION,
UNITED STATES DEPARTMENT OF EDUCATION,
RESPONDENT IN No. 80-2302

PETITIONS FOR REVIEW OF DECISIONS OF THE UNITED STATES DEPARTMENT OF EDUCATION

Argued May 18, 1981

Before ADAMS, ROSENN, and HIGGINBOTHAM,
Circuit Judges

(Opinion Filed October 13, 1981)

OPINION OF THE COURT

ROSENN, *Circuit Judge.*

These petitions for review of final decisions of the United States Department of Education ("Department" or "Agency")[1] present important questions of first impression in this court. The decisions under review are orders directing petitioners New Jersey and Pennsylvania ("States") to refund to the Department federal funds distributed to the States under the provisions of Title I of the Elementary and Secondary Education Act of 1965 as amended[2]

[1] The Department of Education was created by the Department of Education Organization Act, Pub. L. No. 96-88, 93 Stat. 668 (1979) (codified at 20 U.S.C. §§ 3401-3508 (Supp. III 1979)) and is the successor agency to the former Office of Education ("OE") in the Department of Health, Education and Welfare ("HEW"). The transfer of functions authorized by the act occurred on May 4, 1980, at the direction of the President. Exec. Order No. 12,212, 3 C.F.R. 255 (1981), *reprinted in* [1980] U.S. Code Cong. & Ad. News 7826. Only the very last stages of the adminsitrative proceedings in the cases before us took place after the transfer of functions. However, for purposes of clarity, the former designations of "Office of Education" and "Commissioner of Education" will be used in this opinion only when precision is necessary, otherwise being subsumed in the references to the "Department of Education" and the "Secretary of Education."

[2] Pub. L. No. 89-10, 79 Stat. 27, *amended by* Pub. L. No. 89-750, 80 Stat. 1191 (1966); Pub. L. No. 90-247, 81 Stat. 783 (1967); Pub. L. No. 91-230, 84 Stat. 121 (1969, *enacted* 1970); Pub. L. No. 92-318, 86 Stat. 235 (1972); Pub. L. No. 93-380, 88 Stat. 484 (1974); Pub. L. No. 94-482, 90 Stat. 2081 (1976); Pub. L. No. 95-112, 91 Stat. 911 (1977); Pub. L. No. 95-561, 92 Stat. 2143 (1978); *and* Pub. L. No. 96-46, 93 Stat. 338 (1979). The various pieces of amending legislation will be referred to by the date contained in their short titles—*e.g.*, 1969 Amendments. Footnote references to public law number and session law citation will be provided as appropriate.

("ESEA") and determined by the Agency audits to have been misapplied under the terms of that Act and its implementing rules and regulations.[3] The States have refused to comply with the Department's directives because they contend that the Agency is without authority under the Act to recover through administrative proceedings Title I funds that were misspent during the years in question.[4] Additionally, New Jersey challenges the correctness of the Agency's audit findings; Pennsylvania challenges the Department's interpretation and application of the Act's statute of limitations and claims that its rulemaking procedures are deficient. We reach only the question of the Agency's claimed authority to issue the orders presently before us and conclude that such authority does not exist. We therefore reverse.

I.

In 1965, as his education program was nearing floor debate in the Senate, President Johnson, com-

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[3] 45 C.F.R. pts. 116 & 116a (1980) (to be transferred to 34 C.F.R. pts. 200 & 201 (1981)). In addition to these codified regulations the Agency implements the Act in several less formal manners. For example, the Agency has established mandatory criteria in its program guidelines, which are distributed to nonfederal agencies preparing applications for participation in Title I. The Agency also distributes program manuals to participating entities and will often issue letter memoranda in response to inquiries of local or state educational agencies. *See generally* The National Institute of Education, DHEW, *Administration of Compensatory Education* 5-7 (Report to Congress 1977).

[4] New Jersey's Title I program was audited for the period September 1, 1970 through August 31, 1973. The Department's assessment against Pennsylvania stems from an audit report of that state's program from July 1, 1967 through June 30, 1973.

menting on the bill that was to become the Elementary and Secondary Education Act of 1965, said: "This bill has a simple purpose: To improve the education of young Americans."[5] Beginning with the ESEA, legislation passed in pursuit of that laudable objective fundamentally altered the federal government's remote role in education. The Senate committee report on ESEA notes this change in direction by quoting Senator Taft's statement expressing Congressional concerns prompting the legislation:

> "Education is primarily a State function, but in the field of education, as in the fields of health, relief, and medical care, the Federal Government has a secondary obligation to see that there is a basic floor under those essential services for all adults and children in the United States."

S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. Code Cong. & Ad. News 1450. According to educational statistics then before the Congress, the nation had almost fallen below the "basic floor" referred to by Senator Taft and this encouraged federal intervention.[6]

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[5] S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. Code Cong., & Ad. News 1448.

[6] According to the Senate report,

> The purpose of this legislation is to meet a national problem. This national problem is reflected in draft rejection rates because of basic educational deficiencies. It is evidenced by the employment and manpower retraining problems aggravated by the fact that there are over 8 million adults who have completed less than 5 years of school. It is seen in the 20-percent unemployment rates of our 18- to 24-year-olds. It is voiced by our institutions of higher learning and our vocational and technical edu-

Without doubt, the provisions of ESEA Title I effectuated one of the most ambitious federal forays into the educational domain. Confronted with overwhelming evidence of a direct link between economic privation and educational underachievement, Congress authorized a massive [7] infusion of federal funds into the nation's public school systems for the improvement of the educational lot of children from low-income families. In Title I, however, Congress has done more than simply "throw money at a problem." The statutory scheme has been carefully constructed to ensure that the funds appropriated for the benefit of disadvantaged schoolchildren are actually applied and distributed in the most equitable and efficient manner.

For example, the amount of a grant to a particular local educational agency ("LEA") is determined by direct reference to the number of children from low-income families eligible to attend the schools served by the LEA. Pub. L. No. 874, tit. II, § 203, *as added by* Pub. L. No. 89-10, tit. I, § 2, 79 Stat. 27, 28 (1965) (*codified as amended at* 20 U.S.C. § 2711 (Supp.III 1979)). Federal funds are to be distributed only after the state educational agency

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cators who have the task of building on elementary and secondary education foundations which are of varying quality and adequacy.

S. Rep. No. 146, 89th Cong., 1st Sess., *reprinted in* [1965] U.S. Code Cong. & Ad. News 1449.

[7] In Title I's first year, Congress appropriated $775,000,000 to the program. Departments of Labor, and Health, Education, and Welfare Supplemental Appropriation Act, 1966, Pub. L. No. 89-199, ch. II, 79 Stat. 831, 832 (1965). By 1979, funding levels had reached $3,077,132,000. Departments of Labor and Health, Education, and Welfare Appropriations Act, 1979, Pub. L. No. 95-480, tit. II, 92 Stat. 1567, 1577 (1978).

("SEA") to which the particular LEA is responsible has provided assurances that the LEA, under the SEA's direction, will expend the federal monies only on "programs and projects . . . (A) which are designed to meet the special education needs of educationally deprived children in school attendance areas having high concentrations of children from low-income families and (B) which are of sufficient size, scope, and quality to give reasonable promise of substantial progress toward meeting those needs . . . ." Pub. L. No. 874, tit. II, § 205, *as added by* Pub. L. No. 89-10, tit. 1, § 2, 79 Stat. 27, 30 (1965) (*codified as amended at* 20 U.S.C. § 2734 (Supp.III 1979)).

The federal program prohibits the use of funds to supplant an existing state-funded compensatory education program, requires LEA's to maintain their existing commitment in the area as a condition to continued eligibility, and prescribes that only the excess costs incurred as a result of instituting Title I programs shall be paid with Title I funds. 20 U.S.C. § 2736 (Supp.II 1979). The Act also establishes very definite criteria to be used in identifying the schools and attendance areas in which Title I funds may be expended, 20 U.S.C. § 2732 (Supp.III 1979), as well as the children that may be served. 20 U.S.C. § 2733 (Supp. III 1979). As might be expected, the specificity and complexity of the statutory restrictions on the use of Title I funds are modest when compared with the intricate set of rules and regulations adopted by the administering federal agency. *See* 45 C.F.R. pts. 116 & 116a (1980) *and* note 3 *supra*.

Although this overview of the program might suggest a rigid and pervasive federal presence at all levels of Title I administration, in keeping with traditional governmental roles in education, Congress actually entrusted most of the responsibility for man-

agement to the SEA's and the primary responsibility for innovative program development to the LEA's. Basically, the Act contemplates that each LEA that desires to receive Title I funds will file an application detailing its needs, its eligibility, and the intended uses for the requested funds. This application is submitted to the SEA, which verifies its accuracy and ensures that all proposals conform with current Title I guidelines. The SEA after collecting all LEA applications from its jurisdiction, then submits its own application to the Department for the aggregate sum to which its LEA's are eligible (according to their applications), plus an amount for administration expenses. This application is accompanied by assurances from the SEA that the funds will be used only for lawful Title I purposes.

The resolution of the questions presented by this case therefore is of considerable importance in administering the Title I program. Congress chose to rely heavily on the States to assure proper application of Title I funds, but committed to the Department the authority to adopt such rules and regulations as it deemed appropriate. Such a division of responsibility must inevitably lead to conflicts between the SEA's and the Department over the proper application of Title I funds. When conflicts have developed, the Department has resorted to a variety of procedures, all directly related to its power over the purse strings, to enforce its interpretation of the Act against the States. Some, such as withholding funds or refusing to approve applications, find their roots in the clear and unambiguous terms of the statute in effect when the deposited funds were received. Pub. L. No. 874, tit. II, §§ 206, 210, *as added by* Pub. L. No. 89-10, tit. I, § 2, 79 Stat. 31, 33 (1965) (*codified as amended at* 20 U.S.C. §§ 2832,

2836 (Supp. III 1979)). In this case, however, the Department adopted procedures for the Pennsylvania and New Jersey audit proceedings not clearly authorized by the statute under which the funds were disbursed. It is this variance in procedure that is the genesis of this litigation.

A.

To understand fully the issue we decide today, a brief examination of the administrative proceedings that have brought these cases to us is necessary. The Department, in carrying out its statutory responsibilities, performed separate audits of the Pennsylvania and New Jersey Title I programs. The initial audits were performed by auditors employed by the Department of Health, Education and Welfare Audit Agency ("HEWAA"). In its final audit reports, issued in April (Pennsylvania) and June (New Jersey) of 1975, HEWAA found that both States had misapplied substantial sums of federal Title I monies during the periods under investigation. These reports were forwarded to the Deputy Commissioner for Elementary and Secondary Education, who solicited responses from the States. On May 18, 1976, the Deputy Commissioner issued a final audit determination letter on the Pennsylvania audit. In his letter addressed to the SEA, the Deputy Commissioner sustained the audit findings that $1,346,399.00 had been misspent in Pennsylvania during the audit period and ordered the State to refund that sum to the Department. He sent a similar final audit determination letter to the New Jersey SEA on June 11, 1976, and demanded a refund of $1,161,917.00.

Upon receipt of the Deputy Commissioner's final audit determination letters, both States filed applications for review with the Title I Audit Hearing

Board.[8] Panels of that Board held hearings[9] on the State's objections and, in written decisions dated February 19, 1980, (New Jersey) and May 7, 1980, (Pennsylvania), modified the Deputy Commissioner's findings and assessed audit deficiencies of $1,031,304[10]

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[8] The Department's briefs to this court explain that "[a]lthough under no legal requirement to do so, OE created the Board to give [SEA's] a fair opportunity to rebut adverse final audit determinations of the Deputy Commissioner before an independent administrative tribunal."

[9] On June 29, 1979, the Education Appeal Board ("EAB" or "Board"), created by Pub. L. No. 95-561, tit. XII, § 1232, 92 Stat. 2347 (1978) (*codified at* 20 U.S.C. § 1234 (Supp. III 1979)) assumed jurisdiction of all cases then pending before the Title I Audit Hearing Board. 44 Fed. Reg. 43807 (July 26, 1979). However, the transfer of functions caused few practical disruptions because the composition of the EAB was identical to that of the Title I Audit Hearing Board. Pennsylvania, however, claims to have suffered from the transfer because the notice of the establishment of the EAB, given May 25, 1979, 44 Fed. Reg. 30528, which included rules governing procedures before the EAB indicated that the procedures were in effect immediately. Thus, Pennsylvania claims, and the Department does not deny, that the State was forced to try the portion of its case heard after May 25, 1979, under new and unfamiliar rules. Pennsylvania also asserts that the Department's final regulations governing the EAB, substantially identical to the interim final regulations under which post-May 25 hearings were held, were disapproved by Congress pursuant to 20 U.S.C. § 1232(d) (1976 & Supp. III 1979).

[10] This reduction resulted from the application of a five-year statute of limitations enacted in 1974. Pub. L. No. 93-380, tit. I, § 106, 88 Stat. 484, 512, *originally codified at* 20 U.S.C. § 884 (1976), *renumbered and replaced*, Pub. L. No. 95-561, §§ 801(2), 901(b), 93 Stat. 2284, 2305 (1978), *as amended by* Pub. L. No. 96-46, §§ [1](20), 2(a)(3), 93 Stat. 339-40 (1979). *Cf.* Pub. L. No. 90-247, tit. IV, § 452(g), *as added by* Pub. L. No. 95-561, § 1232, 92 Stat. 2347-49 (1978) (pre-

against New Jersey and of $422,424.29 [11] against Pennsylvania. The Board's decisions were subject to a comment period during which they were forwarded to the Secretary, who declined to review them. The Board's decision as to New Jersey became the final decision of the Department on May 2, 1980; the decision as to Pennsylvania became final on July 16, 1980. Timely petitions for review were filed in this court.[12]

As explained earlier, both Pennsylvania and New Jersey contend that, to the extent the above-described procedures directed the payment of a refund by the SEA's, the procedures were outside the Department's statutory authority. The Department responds by citing two statutory provisions that it urges explicitly authorize the procedures followed in these cases. Alternatively, the Department relies on a common-law right of the Government to recoup grant funds expended in violation of the terms and conditions of the grant. We turn first to the statute.

B.

The Government's dilemma lies not in the unreasonableness of its demands for the return of the

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scribing a five-year statute of limitations for refund proceedings effected under the General Education Provisions Act).

[11] This reduction resulted from an application of the statute of limitations, *see* note 10 *supra* and from a determination that funds had not been misspent in one of the five LEAs that were the subject of HEWAA audit deficiencies.

[12] Jurisdiction of this court is proper under either 20 U.S.C. § 2851 (Supp. III 1979) (authorizing appeals from adverse final action of the Secretary regarding Title I audits) or 20 U.S.C. § 1234d (Supp. III 197?) (authorizing appeals from adverse final action of the EAB).

misspent monies but in the absence of a statutory remedy to compel repayment. The Department first invokes a recent addition to the statutory scheme as authority for its actions in these cases. Title I's section 185 (20 U.S.C. § 2835 (Supp. III 1979)) was added by the 1978 Amendments,[13] which effectively rewrote the entire Act. Section 185 directs that when Title I audits disclose a misapplication of grant funds, the Secretary shall take steps to "assure timely

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[13] Pub. L. No. 95-561, tit. I, § 101, 92 Stat. 2143, 2190 (1978), *adding* Pub. L. No. 89-10, tit. I, § 185. The section reads:

> § 2835. Audits and audit resolution
>
> (a) Auditing.—The Inspector General of the Department of Health, Education and Welfare shall make provision for audits of grants made under this subchapter to determine, at a minimum, the fiscal integrity of grant or subgrant financial transactions and reports, and the compliance with applicable statutes, regulations, and the terms and conditions of the grant or subgrant.
>
> (b) Audit resolution and repayment.—The Commissioner shall adopt procedures to assure timely and appropriate resolution of audit findings and recommendations arising out of audits provided for in subsection (a) of this section. Such procedures shall include timetables for each step of the audit resolution process and an audit appeals process. Where, under such procedures, the audit resolution process requires the repayment of Federal funds which were misspent or misapplied, the Commissioner shall require the repayment of the amount of funds under this subchapter which have been finally determined through the audit resolution process to have been misspent or misapplied. Such repayment may be made from funds derived from non-Federal sources or from Federal funds no accountability for which is required to the Federal Government. Such repayments may be made in either a single payment or in installment payments over a period not to exceed three years.

and appropriate resolution of audit findings and recommendations." This audit resolution process is expressly directed to include repayment of funds "finally determined . . . to have been misspent or misapplied." Pointing out that Section 185, and complementary sections contained in the General Education Provisions Act ("GEPA"),[14] were in effect when final agency action was taken in the cases at bar, the Department claims that the decisions under review simply fulfill the statutory obligations of the Agency to ensure the fiscal integrity of Title I at the state and local level.

The States counter the Department's Section 185 argument by invoking the general rule against retroactive application of statutory enactments:

> "[T]he first rule of construction is that legislation must be considered as addressed to the future, not the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be 'the unequivocal and inflexible import of the terms, and the manifest intention of the legislature.'"

Greene v. *United States*, 376 U.S. 149, 160 (1964) (quoting *Union Pacific Railroad* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913)). *See United States* v. *Richardson*, 512 F.2d 105, 106 (3d Cir. 1975).

The States further assert that retroactive enforcement of a newly created governmental right of recovery is especially inappropriate in the context of participatory grant programs involving sovereign States. It is, the States contend, in the nature of

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[14] *See* 20 U.S.C. § 1234, 1234a (Supp. III 1979).

a grant program that a prospective grantee may exercise its prerogative not to participate. However, it is argued, for that prerogative to be exercised knowledgeably and, presumably in the case of governmental entities, in the public interest, it is necessary that the prospective grantee be able to assess the potential risks and benefits that would flow from participation. For this court, it is urged, to enforce retroactively a sanction not mentioned when the grantees entered into the program, would impose serious hardship on States operating under budgetary limitations and would result in a dramatic and undesirable reduction in the participation rates for worthy federal grant programs such as Title I.

The States' arguments are persuasive and in harmony with the views recently expressed by the Supreme Court in *Pennhurst State School and Hospital* v. *Halderman*, 49 U.S.L.W. 4363 (U.S. April 20, 1981). In *Pennhurst*, the Court reversed this court's holding that the Developmentally Disabled Assistance and Bill of Rights Act, 42 U.S.C. §§ 6000-81 (1976 & Supp. III 1979) ("DDA"), imposed affirmative obligations on the states to provide mentally retarded persons with appropriate treatment in the environment that would be least restrictive of their personal liberty. *Halderman* v. *Pennhurst State School & Hospital*, 612 F.2d 84, 94, 107 (3d Cir. 1979) (*en banc*). Referring to Congressional authority to legislate pursuant to the Spending Power,[15] the Court stated: "[O]ur cases have long recognized that Congress may

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[15] The Spending Power is derived from Congress' authority to provide for the general welfare. U.S. Const. art. I, § 8, cl. 1. Department counsel agreed at oral argument that Title I was enacted in exercise of this power.

fix the terms on which it shall disburse federal money to the States." 49 U.S.L.W. at 4367. The *Pennhurst* Court then proceeded to describe Spending Power legislation as

> much in the nature of a contract: in return for federal funds, the States agree to comply with federally imposed conditions. The legitimacy of Congress' power to legislate under the Spending Power thus rests on whether the State voluntarily and knowingly accepts the terms of the "contract." . . . There can, of course, be no knowing acceptance if a state is unaware of the condition . . . . [I]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously . . . . By insisting that Congress speak with a clear voice, we enable the States to exercise their choice knowingly, cognizant of the consequences of their participation.

Id.

We recognize that *Pennhurst* is not directly applicable to the cases before us. That case concerned the imposition of affirmative obligations, the costs of which were not fully covered by grant funds. Nevertheless, the overarching principle of *Pennhurst*—that the terms and conditions of a federal grant must be set forth clearly and unambiguously in the statute authorizing the grant—precludes us from giving retroactive effect to a statute passed five years after the last disputed funds were received. Such a result would require repayment of misspent funds out of a state's general treasury. Section 185 does not confer authority on the Department to impose the sanctions it adopted in these cases.

The Department also relies on Section 415 of the General Education Provisions Act ("GEPA"),[16] currently codified at 20 U.S.C. § 1226a-1 (Supp. III 1979), for authority to recoup misspent Title I funds. That section provides:

> Payments pursuant to grants or contracts under any applicable program may be made in reimbursement with necessary adjustments on account of overpayments or underpayments as the Commissioner may determine.

We are at somewhat of a loss to understand the Department's arguments concerning the operative effect of Section 415. The section is entitled "Payments" and purports to prescribe the manner in which federal funds are paid *to the States*. Therefore, it is clear that whatever "adjustments" are authorized under this provision, they are to be accomplished by means of an offset against current or prospective grant fund disbursements to SEA's. The Department's actions in the cases at bar are very much different and it cannot, therefore, invoke the authority of Section 415.

In fairness to the Department, it should be noted that its arguments respecting Section 415 rely heavily on certain statements in the Senate Report on the 1969 Amendments (which first enacted GEPA Section 415 as Section 425), which seem to indicate a much broader remedial power than we have recognized. *See* S. Rep.. No. 91-634, 91st Cong., 2d Sess.

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[16] Pub. L. No. 90-247, tit. IV, § 425, *as added by* Pub. L. No. 91-230, tit. IV § 401(a)(10), 84 Stat. 170 (1970), *renumbered*, Pub. L. No. 92-318, tit. III, § 301(a)(1), 86 Stat. 326 (1972), *renumbered* Pub. L. No. 95-561, tit. XII, § 1231(a)(1), 92 Stat. 2342 (1978).

83-84, *reprinted at* [1970] U.S. Code Cong. & Ad News 2826.[17] A close reading of the report, however, reveals that the language on which the Department relies, printed under a heading of "REPORTS AND AUDITS," was in fact explanatory of Section 424 of the bill, and that the reference to Section 425 was a typographical error. The committee's remarks concerning Section 425 (now Section 415) are in the immediately preceding paragraph of the report.[18]

Section 424, to which the legislative history quoted in note 17 in fact refers, required grant recipients to maintain appropriate records of Title I expenditures and programs and gave Department officials and mem-

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[17] The Department quoted to the court the following passage from the report:

> The language of section 425 is based on a recommendation of the Comptroller General respecting retention of records and audits relating to education programs.
>
> Audit reports on title I of the Elementary and Secondary Act have been valuable to the committee in its review of that program. The committee notes that exceptions have been taken to certain expenditures of title I during the initial years of the program and, to the extent this committee has reviewed those exceptions, they appear to well founded. Even though there may be difficulties arising from recovery of improperly used funds, those exceptions must be enforced if the Congress is to carry out its responsibility to the taxpayer.

[18] That paragraph reads:

> GENERAL PROVISIONS
>
> Sections 422, 423, and 425 are general provisions concerning the prohibition of Federal control of education, labor standards, and methods of payment. These three sections are a substitute for the numerous similar provisions scattered throughout present law and obviate the necessity of including similar provisions in any further legislation.

bers of the Comptroller General's staff full access to those records "for the purpose of audit and examination." Although not pressed upon the court, we assume the argument that Section 424, in providing the authority to conduct audits, also authorizes the resolution of audit determinations and that the strong legislative history of the section indicates an intent to utilize refunds as a means of resolution. Such an argument is not unreasonable; in the circumstances of this statutory scheme, however, it is unavailable.

As we alluded to earlier, Title I was a fundamental departure from the traditional federal role in education. Public Law 874, which served as the foundation on which the 1965 ESEA was built, limited federal aid to areas directly affected by local federal activity, especially that activity related to the war effort. *See* S. Rep. No. 2458, 81st Cong., 2d Sess., *reprinted in* [1950] U.S. Code Cong. & Ad. News 4014. We think it likely, in light of the historic underpinnings and the experimental nature of Title I, that Congress desired to receive accurate and reliable information on the program's strengths and weaknesses. That such information was earnestly sought and utilized is reflected by the number and breadth of the ESEA amendments. *See* note 2 *supra*. Despite the committee's acknowledgment that audit reports had been forthcoming in the past, we believe that Section 424 was enacted as a means of assuring the continued flow of information to the Department and Congress.

We find support for our conclusion in the 1978 Amendments to the Act which, although they augmented the Act with Section 185 and its GEPA counterpart Section 452,[19] both of which explicitly author-

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[19] Pub. L. No. 90-247, tit. IV, § 452, *as added by* Pub. L. No. 95-561, tit. XII, § 1232, 92 Stat. 2347 (1978) (*codified at* 20 U.S.C. § 1234a (Supp. III 1979)).

ize the Secretary to demand and collect refunds of misspent monies, left in place Section 424 (*codified as amended at* 20 U.S.C. § 1232f (Supp. III 1979)), without significant amendment. Were we to read Section 424 as authorizing the procedures used and the orders issued in the instant cases, not only would we be ascribing to Congress a useless act in enacting Section 185, but we would be construing the Act to contain plain redundancies. Neither course is appropriate.

The Department has been very thorough in marshalling its arguments before this court. Barely a line of legislative history supporting the existence of recoupment authority during the time these funds were received has escaped attention in its oral argument or brief. The States also have made extensive efforts to support their position in the reports and discussion of Congressional committees and members. The parties' assiduousness, however, has failed to provide the requisite legislative history which compels either interpretation of the statute. In view of this void, we look to the terms of the statute itself for the clarity of expression demanded of Congress when States are asked to put at risk substantial rights and benefits in exchange for their participation in a federal grant program. We have studied this statute carefully; we have also closely reviewed the Department's regulations. We cannot say with the necessary firmness of belief that prior to 1978 Congress conferred upon the Department the authority it here asserts against the States. We are constrained, therefore, to deny the statutory power of the Agency to order repayment of the misspent or misapplied funds.

C.

As an alternative source of authority, the Department invokes the common-law right of the Government to recover money and property distributed contrary to law or under a mistake of fact. *See Rex Trailer Co.* v. *United States*, 350 U.S. 148, 151 (1956); *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 239-40 (1947); *Wisconsin Central Railroad* v. *United States*, 164 U.S. 190, 206, 211 (1896). Arguing that federal agencies are free—perhaps obligated—to avail themselves of this remedy to recover misspent funds, the Department cites to *United States* v. *Marion County School District*, 625 F.2d 607 (5th Cir. 1980); *Mt. Sinai Hospital* v. *Weinberger*, 517 F.2d 329 (5th Cir. 1975); and *Utah State Board of Vocational Education* v. *United States*, 287 F.2d 713 (10th Cir. 1961).

Although not willing to concede that a common-law right of recovery exists in the circumstances of these cases, the States argue that even assuming the Department could pursue such a remedy for Title I violations, it would have to do so by instituting an appropriate action in a court of competent jurisdiction. Because all proceedings leading up to the decisions presently under review were conducted at the administrative level, the States contend that those decisions, insofar as they require a refund of misspent monies, are a nullity. In support of their arguments, they cite *School Board* v. *Department of Health, Education and Welfare*, 525 F.2d 900 (5th Cir. 1976).

As evidenced by the citation of authority *supra* at 16-17, there can be no debate concerning the right of the Government "to make contracts and hold and dispose of property, and, for the protection of its prop-

erty rights, . . . resort to the same remedies as a private person." *Rex Trailer Co.* v. *United States*, 350 U.S. at 151. However, where a legislative body provides for liability coupled with a special statutory remedy, "that remedy, and that alone, must be employed." *Pollard* v. *Bailey*, 87 U.S. 520, 527 (1874). *See also National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974) ("A frequently stated principle of statutory construction is that when legislation expressly provides a particular remedy . . ., courts should not expand the coverage of the statute to subsume other remedies."). The States have presented a strong argument that by providing for the withholding of funds and disapproval of SEA applications, Congress intended to abrogate whatever common-law causes of action the Department may have had to redress noncompliance with the federal Title I scheme. The Department makes an at least equally persuasive argument, grounded in legislative history [20] and an analysis of the operation of the statutory remedies [21] that Congress did not intend that the Department be without a remedy to recover misspent funds. Therefore, it is argued, if the statute does not provide such authority, Congress must have in-

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[20] The Department especially relies on the enactment, in 1974, of a statute of limitations for recovery of misspent funds. *See* note 10 *supra*.

[21] Withholding and disapproval of applications, it is contended, are effective only to correct current violations of Title I. Once the SEA brings its program into compliance, the withholding must terminate and the application must be approved. Without the availability of a common-law right of recovery, the Agency argues, it is powerless to correct past violations of Title I.

tended to leave the common-law remedies intact. In the circumstances of these cases, we need not now decide whether a common-law right of recovery survived enactment of the ESEA because if such a remedy does exist, the method of distributing Title I monies lends itself to enforcement of that right only by an action in a court of competent jurisdiction.

Of the case relied on by the Department, only *Mt. Sinai Hospital* v. *Weinberger*, 517 F.2d 329 (5th Cir. 1975) involved a wholly administrative utilization of a common-law right of recovery. In *Mt. Sinai*, HEW withheld funds owing to the hospital for past services rendered to Medicare patients. HEW's action was prompted by the agency's determination that, on other occasions in the past, the hospital had rendered services that were not medically necessary but had nevertheless been paid for with Medicare funds. The hospital brought court action seeking an injunction directing the agency to release the funds and to pay them over to the hospital. The district court granted the injunction, holding that HEW's common-law right of recoupment had been abrogated by enactment of the comprehensive Medicare statute. The Fifth Circuit reversed on the abrogation issue.

The remedy of setoff which HEW sought to employ in *Mt. Sinai*, however, is inappropriate in these cases because of fundamental differences between the funding scheme employed by HEW in *Mt. Sinai* and the scheme under Title I. Medicare funds are distributed to participating health care providers by way of reimbursement for services already rendered. Thus, if HHS [formerly HEW] utilizes its common-law right of setoff, which is available to anyone holding funds owing to another from whom a debt is owing, Medicare beneficiaries still receive treatment, but the Government need not pay for those services outside the

program's coverage. The same remedy was used in *Wisconsin Central Railroad* v. *United States*, 164 U.S. 190 (1896), dealing with recovery of illegally disbursed payments for mail carriage by a land grant railroad, and *United States* v. *Munsey Trust Co.*, 332 U.S. 234 (1947), concerning the offset of "cover costs" resulting from the breach of a government construction contract against an amount owing the defaulting contractor from the completion of other contracts.[22] In contrast, the Department uses an advance-funding method of distributing Title I funds, presumably because school districts are unable to function on an anticipated revenue basis. For the Department to attempt to use an offset remedy, therefore, would result in the failure of the school districts to provide Title I services during the year for which funding was withheld. This is obviously unsatisfactory as it defeats Congressional objectives and it means that the intended beneficiaries of the Act—underprivileged school-children—not only suffer when the funds are misapplied but also when the Department attempts to remedy the misapplication.

The Department has not referred us to any case in which a governmental right of recovery was administratively exercised by a means other than setoff and sustained by a court that had analyzed the issue.[23]

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[22] *See also* Lodge 2424, Int'l Ass'n of Mach. & Aerospace Workers v. United States, 564 F.2d 66 (Ct. Cl. 1977).

[23] The Department's reference to West Virginia v. Commissioner of Education, No. 79-1338 (4th Cir. 1980) (unpublished per curiam) is not helpful, even though that case dealt with an order of the Department resulting from procedures similar to those employed here. The court's opinion fails to reveal that the arguments considered in this opinion were pressed and, in such absence, we will not assume that the Fourth Circuit ruled on the issue that presently confronts us.

We have found only one such case, *Admiral-Merchants Motor Freight, Inc.* v. *United States*, 321 F.Supp. 353 (D.Colo. 1971), and the peculiar facts of that case, coupled with the court's use of equitable estoppel, *id.* at 359, render the case inapposite to the one at bar. Further, the law announced in the case militates strongly against upholding the Department: "[A] legislative tribunal cannot exercise common law or equity jurisdiction unless this authority is expressly granted by the Congress." *Id.* at 359. *See also School District* v. *Department of Health, Education, and Welfare*, 525 F.2d 900 (5th Cir. 1976) (HEW hearing examiner had authority only to determine eligibility of grant recipient, not to order refund or funds dispersed to ineligible grantees).

In the absence of any authority to the contrary, we conclude that the Department, if it retains a common law right to recover misspent Title I funds, may exercise that right only by maintaining a civil action in a court of competent jurisdiction. We note that such a rule assures that the parties to the audit are able to press their arguments concerning the merits of the audit in a judicial forum, either in the Agency-initiated proceedings or in an action seeking to have the Agency remit withheld funds. The Department itself argues to this court that such an opportunity was unavailable to audited parties prior to enactment of the 1978 Amendments. Because neither of the allowable courses were followed in these cases, we may not sustain the orders directing the States to repay the funds determined to have been misspent.

II.

Our decision in these troublesome cases is reached only after carefully weighing the effect it may have

upon a valuable national educational program. Title I is an important cornerstone in the federal aid to education program and, by most accounts, it is proving reasonably successful in securing the advantages of education for the seriously disadvantaged. Misapplication of funds, even though it occurs in a good-faith effort to comply with complex regulatory requirements, detracts from the effectiveness of the program as a whole. It cannot be condoned or dismissed lightly. Administrative agencies, however, are purely creatures of statute, and their authority is statutorily circumscribed. To allow an agency to assume powers that it considers appropriate in carrying out its duties but which have not been allotted to it by Congress would attribute legislative powers to the executive branch and disturb the balance in our tripartite system of government. More important, perhaps, would be the absence of due process in a system where agencies charged with administering the multitude of federal grant programs were free to augment or abridge the rights and obligations forming the contractual basis of the grantees' participation. Title I participants who have received funds after the effective date of the 1978 Amendments have been advised by Congress that they will be held responsible in administrative proceedings with a right of judicial review for Title I funds that are misapplied. Requiring less is simply inconsistent with our concept of fairness.

We therefore hold that an administrative agency has no authority to order repayments of funds misapplied or misspent by federal grant participants unless Congress, at the time the funds are received, has declared its intention to empower the agency to exercise such a remedy. In the absence of Congres-

sional authority, the remedy exists, if at all, only at common law. We further hold that if an agency employing an advance-funding scheme such as that provided for in Title I relies on a common-law right to recover misspent funds, it may do so only by maintaining a civil action in a court of complete jurisdiction.

Accordingly, the petitions for review will be granted and the orders of the Department will be reversed and the cases remanded with instructions to vacate the orders requiring a repayment by petitioners of previously received Title I funds.[24]

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[24] Because we do not reach the issue of the regularity of the proceedings at the agency level, the Department's motion to strike the affidavit of William M. Dallam, appended to petitioner Pennsylvania's reply brief, will be granted.

A. LEON HIGGINBOTHAM, *Circuit Judge*, Concurring.

I concur in the holding of the court, specifically, that the Department was not empowered by statute to order the states to repay the amounts that were determined to have been misspent.

I cannot agree that the issue of what common law remedies the Department may have had is properly before us, because it is clear that no such remedies were exercised by the Department in these cases. I therefore believe that the court's discussion of the scope of the Department's setoff remedy is dictum.

With that understanding, I concur.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 80-1991

STATE OF NEW JERSEY, DEPARTMENT OF EDUCATION, PETITIONER

v.

SHIRLEY HUFSTEDLER, SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION, RESPONDENT

No. 80-2302

COMMONWEALTH OF PENNSYLVANIA, PETITIONER

v.

SECRETARY OF EDUCATION, UNITED STATES DEPARTMENT OF EDUCATION, RESPONDENT

ON PETITIONS FOR REVIEW OF DECISIONS OF THE UNITED STATES DEPARTMENT OF EDUCATION

Present: ADAMS, ROSENN and HIGGINBOTHAM,
Circuit Judges

JUDGMENT

These causes came on to be heard on the records from the United States Department of Education and were argued by counsel on May 18, 1981.

On consideration whereof, it is now here ordered and adjudged by this Court that the petitions for review be and the same are hereby granted and the orders of the said Department dated May 7, 1980, and appealed at No. 80-1991, and July 16, 1980 and appealed at No. 80-2302, be, and the same are hereby reversed and the causes remanded for vacation of the orders requiring repayment by petitioners of previously received Title I funds, in accordance with the opinion of this Court. Costs taxed against respondent.

ATTEST:

Clerk

/s/ Sally Mrvos

October 13, 1981

Certified as a true copy and issued in lieu of a formal mandate on December 28, 1981.

Test:

/s/ Sally Mrvos
Clerk

United States Court of Appeals
for the Third Circuit

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Nos. 80-1991 & 80-2302

No. 80-1991

STATE OF NEW JERSEY, DEPT. OF EDUCATION, PETITIONER

v.

SHIRLEY HUFSTEDLER, ETC.

No. 80-2302

COMMONWEALTH OF PENNSYLVANIA, PETITIONER

v.

SECRETARY OF EDUCATION, ETC.

SUR PETITION FOR REHEARING EN BANC

Present: SEITZ, *Chief Judge*, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER, WEIS, GARTH, HIGGINBOTHAM and SLOVITER, *Circuit Judges*.

The petition for rehearing filed by Respondent in the above entitled case having been submitted to the judges who participated in the decision of this court

and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied

By the Court,

/s/ Arlin M. Adams
Circuit Judge

Dated: December 17, 1981

APPENDIX D

DEPARTMENT OF HEALTH, EDUCATION AND WELFARE

EDUCATION APPEAL BOARD

Docket No. 14-(29)-76

Appeal of

THE STATE OF NEW JERSEY
TITLE I, ESEA

DECISION

Appearances: Mark Schorr, and Jane Sommer for the State of New Jersey; Philip H. Rosenfelt and Robert Arnot for the Deputy Commissioner of Elementary and Secondary Education.

I. *Preliminary Statement*

On June 11, 1976 the Deputy Commissioner for the Bureau of Elementary and Secondary Education, Department of Health, Education and Welfare ("Deputy Commissioner") issued a final determination letter to the New Jersey State Department of Education ("New Jersey" or "New Jersey SEA") demanding a refund in the amount of $1,161,917 to satisfy certain claimed deficiencies relating to expenditures by New Jersey through its Newark Local Education Agency ("Newark" or "Newark LEA") of Title I funds during the school years 1970-71 and 1971-72.

The Deputy Commissioner's claimed refunds are based on the H.E.W. audit agency's findings of June 20, 1975, which are summarized in Enclosure No. 1 to the Deputy Commissioner's letter of June 11, 1976, as follows:

a. $91,266 in Title I funds were improperly spent during the 1970-71 school year at the Lafayette

School, which was found to be ineligible for such funds on the basis of the low-income percentage shown on the face of Newark's application to the New Jersey SEA.

b. $41,102 in Title I funds were improperly spent during the 1970-71 school year at 10 Newark schools because these schools were not listed in the LEA's application as eligible for Title I funds.

> (By reason of the application of the federal statute of limitations, 20 U.S.C. § 884 (Supp. IV 1974), it has been stipulated that all but $1,674 have been eliminated from the above two claims. Attempts at settlement failed; and the parties have requested the panel to determine whether the Deputy Commissioner is entitled to the reduced claim for $1,674.)

c. $1,029,630 in Title I funds were improperly spent during the 1971-72 school year because the method used by the Newark LEA to determine the eligibility of attendance areas deviated from the applicable Title I regulations, and particularly § 116.17 (d) thereof. Ten elementary schools and three secondary schools were found to have been ineligible.

On May 12, 1977, the undersigned Panel of the Education Appeal Board (formerly the Audit Hearing Board) met to consider New Jersey's appeal at a pre-hearing conference. The points agreed on at this conference were summarized in a pre-hearing conference statement issued by the Panel on June 29, 1977. Pursuant to the schedule adopted by the Panel at that pre-hearing conference, counsel then exchanged written interrogatories and responses were made.

On September 2, 1977, New Jersey filed a motion to compel answers to certain of its interrogatories to

which the Deputy Commissioner had objected and the Deputy Commissioner responded to this motion.

The Panel considered the papers submitted and by a memorandum opinion and order dated February 10, 1978, held that it does not have authority to compel discovery, including answers to interrogatories, and that the Panel's role is limited to encouraging the parties to undertake voluntary discovery.

The Panel went on to advise the parties with respect to whether several of the New Jersey interrogatoreis objected to by the Deputy Commissioner could, in the Panel's opinion, be answered and to what extent. This, however, was simply informal advice to counsel for the parties.

On March 31, 1978, counsel for both parties filed a joint pre-hearing memorandum, together with New Jersey's statement of factual and legal contentions and the Deputy Commissioner's statement of the issues presented and his position thereon. In their joint pre-hearing memorandum, counsel for the parties indicated that neither party requested an evidentiary hearing at that time, *i.e.*, March 1978.

On April 17, 1978, the Panel adopted the briefing schedule that had been jointly proposed by both parties. The following briefs were filed on the in-indicated dates:

a. On June 2, 1978, New Jersey filed its main brief together with an affidavit of Bernard J. Brandwene and an appendix and certain exhibits.

b. On August 4, 1978, the Deputy Commissioner filed its main brief, together with certain exhibits, including Exhibit F, the affidavit of Alan Bergman.

c. On September 11, 1978, New Jersey filed a letter reply brief, and on November 9, 1978, New Jersey filed a supplemental affidavit of Bernard J. Brandwene.

d. On September 12, 1978, New Jersey filed a motion to suppress the affidavit of Alan Bergman and the Deputy Commissioner responded.

e. On January 9, 1979, the Deputy Commissioner filed a supplemental affidavit of Alan Bergman.

f. On January 10, 1979, the Deputy Commissioner filed comments concerning the supplemental affidavit of Mr. Brandwene.

The Panel considered New Jersey's September 12, 1978 motion to suppress and by memorandum order dated March 8, 1979, denied it. At the same time, it noted that neither party had requested an evidentiary hearing and certain other matters. In its memorandum the Panel requested that counsel for the parties address the following principal issues at oral argument:

> (1) Whether the Commissioner of Education is without jurisdiction to compel New Jersey to refund the Title I monies allegedly improperly spent.
>
> (2) Whether the New Jersey SEA, in approving the Newark LEA's 1971-72 Title I project application, failed to comply with the then prevailing regulations establishing project eligibility.
>
> (3) Whether New Jersey's recalculation of low income percentages made after the acceptance of the project application by the SEA and approval of the Office of Education of the grant award are relevant to this appeal.

(4) If so, whether the method used by New Jersey in making its recalculation meets the then applicable Office of Education regulations and program criteria for Title I program awards.

(5) If so, whether such calculation supports New Jersey's contention that the grant was properly made and no refund is required.

(6) Assuming that the answer to any of the foregoing three questions is in the negative, is there any other ground whereby the grant award to the Newark LEA may be supported, including possible designation of the Newark LEA as a district-wide Title I target area?

With respect to all but the second issue, the parties stipulated that the issues have been joind. With respect to the second issue, the New Jersey SEA does not contend that Newark's LEA-71-72 Title I application complied with the then prevailing regulations establishing project eligibility.

Counsel for the parties ably and thoroughly addressed the principal issues at an oral argument on June 21, 1979. At this argument the Panel rejected counsel for New Jersey's request to introduce a further supplemental affidavit of Bernard Brandwene, an accountant for New Jersey, in view of the lateness of the offer and New Jersey's prior agreement to waive an evidentiary hearing. We will now consider the various issues.

II. *Findings of Fact and Conclusions*

A. *Deputy Commissioner's reduced claim for $1,674 refund for the 1970-71 school year.*

As noted above, the parties have stipulated that all but $1,674 of claim "a" ($91,266) and claim "b"

($41,102) have been eliminated by application of 20 U.S.C. § 884 (Supp. IV 1974), the federal statute of limitations. At oral argument counsel for New Jersey submitted the question of its obligation to refund the $1,674 on the bases of points 1 and 4 of its principal brief, filed June 2, 1978, and counsel for the Deputy Commissioner submitted on the basis of Appendix A to its principal brief filed August 4, 1978, which addresses points 1 and 4 above. Point 1, which challenges the Commissioner's authority to require SEA's to refund Title I funds determined to have been improperly spent, is resolved against New Jersey in Part B, below. Point 4, which contends that Newark could have been declared a district-wide Title I target area during the 1971-72 school year, is not relevant to the audit findings relating to the 1970-71 year because New Jersey does not include any evidence concerning the variance in low-income percentages in Newark during the latter year. Nor do we see how such a conclusion can be deduced from the evidence relating to the 1971-72 year with regard to Newark's being a district-wide target area, which we in fact reject below. (See *infra* paragraph G.) Hence, the Deputy Commissioner's reduced claim for the $1,674 refund is sustained.

B. *Whether the Commissioner of Education is without jurisdiction to compel New Jersey to refund Title I monies allegedly improperly spent.*

New Jersey claims that the Commissioner is without authority to seek refund of monies allegedly misspent under the Title I grant from the U.S. Office of Education. In principal support of this claim, New Jersey asserts that the Commissioner's remedies under Title I are limited to his power to withhold

funds prospectively (20 U.S.C. 241j). The cited statute provides that, whenever the Commissioner finds a failure to comply substantially with any assurance contained in an SEA's application, he may notify the SEA that further payments will be withheld until he is satisfied that there is no longer any such failure to comply. New Jersey argues that an administrative agency must keep within the powers expressly conferred by law, that its jurisdictional grant should be strictly construed, and that the power to demand refunds cannot be implied from the purpose of the basic legislation, which is to pay-over monies to SEAs to meet the special educational needs of educationally deprived children. New Jersey further argues that the Congress knows how to grant express administrative powers to recoup allegedly misspent funds as, for example, in 20 U.S.C. § 631, dealing with construction of urgently needed school facilities in federally impacted areas. Further, New Jersey cites Section 9(b) of the Administrative Procedure Act (5 U.S.C. § 558(b)) which provides that "a sanction may not be imposed . . . except within jurisdiction delegated to the agency and as authorized by law." Thus, New Jersey concludes that because no authority is expressly set out in the enabling statute and none can reasonably be attributed to any conceivable educational purpose, the authority does not exist and the Commissioner is without jurisdiction to require a refund.

The Deputy Commissioner, in response, finds statutory authority for refund proceedings in Section 435 of the General Education Provisions Act, 20 U.S.C. § 1232d, which authorizes the Commissioner to make "adjustments on account of overpayments or underpayments as the Commissioner may determine." In

response to New Jersey's assertion that nothing in the legislative history of Title I suggests that the Commissioner has the power to compel refunds, the Deputy Commissioner cites the Senate report accompanying Section 435, which notes that in prior years audit exceptions had been taken to certain Title I expenditures and that "they appear to be well founded," and "must be enforced if the Congress is to carry out its responsibility to the taxpayers." Sen. Rep. No. 91-634, 91st Cong. 2d Sess. 83-84 (1970). The Deputy Commissioner also finds Congressional intent in the five-year statute of limitation provision enacted in 1974 (20 U.S.C. § 884), in that there would have been no purpose in limiting recoupment to a five-year period prior to receipt by the SEA of final written notice that certain payments were unauthorized if in fact there were no authority in the Office of Education to recoup those payments during the five-year period. The Deputy Commissioner also argues that the Commissioner has a common law right to recoup allegedly misspent monies.

The Panel has given careful consideration to the pros and cons of this basic jurisdictional challenge. We believe that the issue may not have been free from doubt prior to the time that Congress enacted the 1974 statute of limitations. But by that action Congress must have recognized the Commissioner's authority to recoup when it decided to put a time limitation on that very authority. While this is not an express delegation of jurisdiction, it comes close enough, in our view, to satisfy APA Section 9(b). It also indicates a legislative intent expressed with respect to Title I programs which precedes the Deputy Commissioner's final determination letter of June 11, 1976. This issue has been considered and similarly resolved in the Com-

missioner's favor by at least three other panels,* and may ultimately be raised and determined in an appropriate judicial forum. For these reasons, we conclude that the Commissioner is not limited to withholding of future funds but may recover funds improperly spent within the applicable limitation period.

C. *Whether the New Jersey SEA, in approving the Newark LEA's 1971-72 Title I project application, failed to comply with the then prevailing regulations establishing project eligibility.*

As noted above, the New Jersey SEA admits it did not meet the Title I requirements for determining the eligibility of school attendance areas for Title I funding when it approved Newark LEA's 1971-72 project application with respect to 13 Newark schools. Under Section 142(a) of Title I of the basic statute (20 U.S.C. §241f(a)), a state desiring to participate in the Title I program must give an assurance to the Office of Education ("OE") that it will only approve LEA projects which meet Title I requirements and that it will enforce all obligations imposed on LEAs under 45 C.F.R. § 116 et seq. The New Jersey SEA gave OE such an assurance.

1. *The basic eligibility standards for Title I grants.*

The basic eligibility standard for Title I grants to LEAs at the time in issue (20 U.S.C. § 241e(a)(1)) was that payments under the Title be used for proj-

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* *Appeal of the State of New Mexico*, Docket No. 5-(20)-76 (Decision, August 17, 1979); *Appeal of the State of Pennsylvania* Docket No. 10-(25)-76 (Ruling on Prehearing Motion, May 9, 1978), *Appeal of the State of Texas*, Docket No. 7-(9)-74 (Decision, May 10, 1976).

ects designed to meet the special educational needs of educationally deprived children in "school attendance areas having high concentration of children from low-income families." Implementing this provision, § 116.17(d) of the Title I regulations (45 C.F.R. 116.17 (d)) interpreted the quoted statutory language as including: (1) attendance areas in which the number of children from low-income families is as large as, or larger than, the average number of such children in the various attendance areas of the school district; and (2) attendance areas in which the percentage of children from low-income families is as large as, or larger than, the percentage of such children in the school district. Section 116.17(d) also permitted an entire school district to be designated as eligible but only when there was no wide variance in the number or percentage of children from low-income families. For convenience, a copy of § 116.17(d) is attached to this Decision.

In addition, OE published Program Guide No. 44 (issued March 18, 1968) which provided additional instructions for selecting eligible attendance areas. In brief, the Guide provided that for each "attendance area" data must be obtained on (a) the total number of children who, according to their ages, are *eligible* to attend the public school serving that area and (b) the number of such children who are from low income families. Further, it provided that in all cases the number of children considered *eligible* to attend a particular school consists of all children of the appropriate ages, including children attending private schools and children who have dropped out of school.

In addition, the Guide suggested a number of sources of data to determine the number of children from low income families, and primarily two sources:

1. the number of children in families receiving Aid to Families with Dependent Children ("AFDC"), and
2. the number of children receiving free lunches.

It further indicated that housing, health or employment statistics could also be used but that whatever data were used had to be used uniformly throughout the applicant's school district.

Finally, the Program Guide provided a special method for ranking of attendance areas where the schools do not have well defined attendance area boundaries.

2. *The Newark LEA's method of computing low-income percentages listed on its 1971-72 Title I project application admittedly violated the requisite eligibility requirements.*

In determining the eligibility of attendance areas for the 1971-72 school year, the Newark LEA stated in its Title I application that it had relied on one source, the AFDC statistics supplied by the Essex County Welfare Board. Using this source, and employing the following ratio it arrived at a district-wide low-income ratio of 33.9% (32,352 AFDC children divided by the total school age children population of 95,780).

$$\frac{\text{Total Number of Children from AFDC Families in All Attendance Areas}}{\text{Total Number of Children Considered Eligible to Attend Public Schools Serving All Attendance Areas}} = \text{Percentage of Children from Low-Income Families}$$

This method complied with 45 C.F.R. 116.17(d).

Next, under § 116.17(d), the eligibility of a school attendance area is dependent on the relationship between (a) the total number of children *eligible to attend the public school* serving the attendance area, including those attending private schools and those

who had dropped out of school and (b) the number of such children from low-income families. For individual school attendance areas (and as a corollary to the method the LEA used to compute the district-wide low-income percentage) this relationship can be expressed as the following ratio:

$$\frac{\text{Total Number of Children from Low-Income Families in the School Attendance Area}}{\text{Total Number of Children Considered Eligible to Attend the School}} = \text{Percentage of Children from Low-Income Families in the School Attendance Area}$$

However, the Newark LEA did not use this ratio to compute the low-income percentage for the individual school attendance areas. Because of the incompleteness of the available AFDC statistics (which omitted children attending private and special education schools), the LEA decided to use an alternative ratio permitted by Program Guide 44 under certain conditions. The Guide recognized that in those instances where schools may not have ". . . well-defined attendance area boundaries or receive numbers of children from outside the areas that have been designated for those schools . . .," it may be necessary to use a different ratio, which bases the ranking of the attendance areas for such schools on the ". . . percentage or number of children actually enrolled in [rather than eligible to attend] these schools. This ratio can be expressed as follows:

$$\frac{\text{Total Number of Children from Low-Income Families Enrolled in a Specific School}}{\text{Total Enrollment in a Specific School}} = \text{Percentage of Children from Low-Income Families Enrolled in the Specific School}$$

Although the above ratio was not applicable to Newark, which had well-defined attendance areas, the

HEW auditors recognized that Newark had used it because the incompleteness of the AFDC statistics left no other reasonable approach and acknowledged that it was "a reasonable alternative under the circumstances." But the auditors went on to state that, instead of following the above alternative ratio, the Newark LEA:

> . . . devised hybrid ratios which deviated from the method specified in the program guide. The results were unacceptable since there were no direct relationships between the component elements. For each public elementary school, [Newark] included in the numerator the number of [AFDC] children enrolled in that school as well as the total number of [AFDC] children residing in the school attendance area who were enrolled in junior and senior high schools. However, [Newark] limited the data in the denominator to the total enrollment of the elementary school. There was therefore no meaningful relationship between the data shown in the ratio, namely the total [AFDC] statistics for the attendance area and the elementary school enrollment. Lacking this correlation, the ratio had basic mathematical flaws which tended to inflate the low-income percentage for individual elementary school areas and thus to increase improperly the number of eligible attendance areas.

(Final Audit Report, pages 10-11; Tab C, pages 10-11)

Thus, while the Newark LEA used the proper *denominator* (total enrollment in a particular school), it also, as it has admitted, improperly inflated the *numerator* by including not only the AFDC children

who were enrolled in the particular elementary school but also AFDC children residing in that school's attendance area who were enrolled in junior and senior high schools.

Correctly recalculating the low-income percentages for each of the 41 elementary schools presented as eligible in Newark's Title I application on the basis of the above alternative method, the auditors found that 10 of the 41 schools had low-income percentages that were lower than the district-wide average of 33.9 percent. Thus, these ten schools were ineligible for Title I funding. The Panel accepts the auditors' findings, which are consistent with the underlying evidence.

Similarly, the auditors found that Newark had used a different (and also incorrect) method to compute the low-income percentages for the junior and senior high schools. This method involved, as New Jersey has acknowledged, the LEA computing the low-income percentages for junior and senior high schools by averaging the low-income percentages of the "feeder or pipe-line" elementary schools. New Jersey has also recognized that it approved the LEA's 1971-72 Title I project application despite the fact the application contained these errors. In its initial brief, (p. 19) New Jersey acknowledges that

> The flaw in the initial formula was that it tended to inflate low-income percentages in attendance areas in that its numerator consisted of all low-income students in an area while its denominator described only elementary school enrollment.

On the basis of this admitted "flaw" in the formula used, three of the junior/senior high schools were found to be ineligible for Title I funds during the 1971-72 project year.

D. *Whether New Jersey's recalculation of low income percentages made after the acceptance of the project application by the SEA and approval by the Office of Education of the grant award are relevant to this appeal.*

It is New Jersey's position that the recalculations submitted in the affidavit and first supplemental affidavit of Bernard Brandwene, an accountant, support its contention that the grant was properly made and no refund is required, with the exception of the Garfield School and the Hawkins School ($18,779), which New Jersey concedes remain ineligible even under Mr. Brandwene's recalculations. New Jersey further recognizes that "these calculations are in fact an acknowledgment of the fact that there were irregularities in the original grant approval process," Transcript of Oral Argument, June 21, 1979, (p. 26). The Deputy Commissioner contends the three secondary schools (Clinton Place, Weequahic and East Side), for which $157,878 of Title I funds were spent, and for which New Jersey has provided no recalculations should also be excepted. Thus, even if the Panel were to accept the recalculations, $342,657 in Title I funds may have been improperly allocated.

Putting to one side the merits of the recalculations, the threshold question is whether they are relevant to this appeal.

New Jersey advances what is essentially an equitable argument: in justifying what it has done, a state should be able to rely on any evidence relevant to the Board's primary mission, which is to determine whether the Title I funds were used in schools which, in fact, met the eligibility requirements of the federal regulations, and thus met the special educational needs of educationally deprived children, the underlying

policy of Title I. New Jersey refers to the decision of another panel which admitted "substantially similar *ex post facto* evidence" as instructive. *Appeal of California*, Docket No. 4-(15)-75 (Decision, July 6, 1977). In that case, the original application of a California School District for a Title I program clearly indicated on its face that one of the elementary schools to be included was not eligible: *i.e.*, that the application met neither of the 45 CFR § 116.17(d) requirements, since both the *percentage* and the *absolute* number of children from low-income families in the school were *below* the district-wide average. During the appeal, California submitted supplementary evidence to the panel which indicated that the original application was erroneous and that the school was in fact eligible to participate in the District's Title I program. The panel recognized that the situation confronted it with a difficult choice. On the one hand, the District's application was clearly defective, the SEA had incorrectly approved it, and no steps were taken to correct the error until after the project year was completed; the state had also failed to follow the obvious and clearly defined federal regulations in the application approval process and therefore it was apparent that the relevant portion of the Title I award should be refunded to the Federal Government. On the other hand, since the school was in fact eligible to receive Title I funds, no misuse of the funds was really involved. "With some misgivings," the panel decided no refund should be required for the following reasons: (1) the panel recognized that for the goals of this major federal grant program to be reached, it was necessary that specified procedures be followed and explicit information supplied; (2) occasional failures to do so, which could be described as

"unavoidable human error," were to be expected; (3) if such errors occurred regularly, they became a pattern of conduct which could be viewed as "administrative negligence"; (4) such a pattern could jeopardize the very legislative purpose of this multi-billion dollar federal education program; (5) here, since the panel was confronted with one isolated case, it could not conclude that serious "administrative negligence" existed with respect to the state's review of school district applications generally. Accordingly, the California panel concluded that the mistake involved was a technical one, the result of an isolated human error, and that no repayment should be required.

In this case, the Deputy Commissioner counters New Jersey's argument with several points. Perhaps the most persuasive is that if the Panel is to accept after-the-fact documentation and recalculations, the review function could be rendered meaningless; it would in effect convert the Panel into an auditor, which is not its designated function; further, the HEW auditors could not conduct an effective audit if the grantees were permitted, years after the funds had been spent, to use new methods for computing attendance area eligibility. The Deputy Commissioner also seeks to distinguish the California appeal by pointing out that it involved only one (not thirteen as is the case here) school in the district in question, and that it involved only a computational error, not the use of an improper eligibility formula that inflated the low-income percentages for all school attendance areas in the entire school district.

We do not accept the Deputy Commissioner's basic position that under *no circumstances* should a panel consider after-the-fact evidence. The California appeal is a case in point: a single instance involving a

technical (in this case, computational) error. We are not, however, convinced that the New Jersey multi-school situation fits within the California rationale. However, in view of the conclusions we reach below regarding the merits of New Jersey's recalculations, we need not reach the question of their relevance to this appeal.

E. *Assuming New Jersey's post-hoc recalculations are relevant to this appeal, does the method used by New Jersey in making its recalculations meet the then applicable Office of Education regulations and program criteria for Title I program awards?*

New Jersey contends that its recalculations of low-income percentages for the ten elementary schools in question used the method suggested in Program Guide #44:

> "The flaw in the initial formula was that it tended to inflate low-income percentages in attendance areas in that its numerator consisted of all low-income students in an area while its denominator described only elementary school enrollment. In contrast, the ratio used for the recalculations had a numerator comprised of all low-income children from the area while the denominator was made up of *all* children from the attendance area enrolled in elementary, junior high, *and* senior high schools." New Jersey's Initial Brief, pp. 19-20.

In making its recalculations, New Jersey claims to have relied on the following paragraphs of the Program Guide:

"Some schools have no well-defined attendance area boundaries or receive numbers of children from outside the areas that have been designated for these schools. It may be necessary to base the ranking of the attendance areas for such schools on the percentage or number of children from low-income families actually *enrolled* in those schools while recognizing that other children, as explained below, will be included in the 'target population' if the area is found to have higher than average concentration of children from low-income families."

"The purpose of the attendance area requirement is to identify the 'target populations' of children who are to be considered for participation in Title I activities on the basis of educational deficiency and need for special services. Thus, *for schools without well-defined boundaries or where children have been transferring in or out on open enrollment or freedom-of-choice plans, the* 'target population' should include (a) all of the children who are attending the particular public school which on the basis of enrollment has a high concentration of children from low-income families; (b) children who have been attending that school; and (c) children who would be attending that school if they were not attending a private school or another public school under a freedom-of-choice, open enrollment, or another plan designed to bring about desegreation." (Sa 43) (emphasis added)

Based on its interpretation of the above paragraphs, New Jersey considered data based on the *total* number of children eligible to attend the public schools serving

the various attendance areas and the *total* number of low-income children from the respective areas.

New Jersey's reliance on the above paragraphs appears misplaced. As discussed above, the Program Guide includes an alternative method for ranking attendance areas where the schools do not have well-defined attendance boundaries. Although, in the opinion of the HEW auditors, the Newark LEA had well-defined attendance boundaries, they still found it appropriate for New Jersey to use the alternative method of ranking. But, as the Panel reads the above paragraphs, the Guide's intent was that under the alternative method schools were to be ranked on the basis of the percentages of low-income children enrolled in each particular school.

As previously stated, the alternative method in the program guide can be stated:

$$\frac{\text{Total Number of Children from Low-Income Families Enrolled in a Special School}}{\text{Total Enrollment in a Specific School}} = \text{Percentage of Children from Low-Income Families}$$

In its original calculation New Jersey had included in the numerator not only the number of AFDC children enrolled in that particular school but also the total number of AFDC children residing in that school's attendance area enrolled in junior and senior high schools.

In its recalculatins of low-income percentages, instead of correcting the numerator to include only those children from AFDC families enrolled in a particular elementary school, New Jersey has added an improper denominator to the LEA's previous improper numerator, *i.e.*, both the numerator and the denominator incorrectly included children enrolled in junior and senior high schools. This "aggregate enrollment" does not appear to be authorized by either 45 CFR 116.17(d) or Program Guide #44.

As stated in the affidavit of Alan Bergman, an HEW auditor, the second "hybrid" ratio had the following inflationary effect:

> The method used by the SEA to recalculate eligibility (combining enrollment data from junior and senior high schools with enrollment data from the individual elementary school) had the effect of inflating the low-income percentages for all but one of the individual elementary schools in question. The SEA's method had this effect because the junior and senior high schools had higher percentages of low-income enrollment than the elementary schools, as shown below:

Percentage of low-income enrollment for the ten elementary schools in question	23.8*

* These low-income percentages were calculated by dividing the total AFDC enrollment (for each category of schools) by the total enrollment in that category. The statistics used in making these calculations were taken from the LEA's 1971-72 project application and the listing of AFDC enrollment statistics that was furnished to the LEA by the Essex County Welfare Board (a copy of this AFDC listing is attached as Exhibit A).

Percentage of low-income enrollment for the junior high schools included in the SEA's recalculations	50.9
Percentage of low-income enrollment for the senior high schools included in the SEA's recalculations	35.2

> By including the junior and senior high school enrollment data (which had higher concentrations of low-income students) the recalculated elementary school percentages were inflated as shown below:

Elementary School	The 1971-72 low-income enrollment percentage for the individual school attendance area based on the AFDC and enrollment statistics and as computed by the HEWAA auditor	The 1971-72 low-income enrollment percentage for the school attendance as recomputed by New Jersey SEA
Madison	28.8	39.7
Newton St.	31.5	42.8
So. 17th St.	33.5	40.3
Central Ave.	29.4	41.4
Burnet St.	30.2	39.0
Waverly Ave.	31.9	37.2
Franklin	32.4	34.8
M. Garvey	22.9	36.1
Garfield	20.6	26.0
Hawkins	30.3	25.9

In summary, in combining enrollment data from junior and senior high school with enrollment data from individual elementary schools New Jersey employed an impermissible method. By building the junior and senior high school enrollments, which had higher concentrations of low-income students, into the ratio, New Jersey inflated the elementary school low-income percentages so that eight of the ten originally disqualified schools became qualified. New Jersey's method of recalculation is unacceptable.

F. Assuming New Jersey's post-hoc recalculations are relevant to this appeal, do such recalculations support New Jersey's contention that the grant was properly made and no refund is required?

Based on the foregoing analysis, the Panel's answer to this question must be "no."

G. *Assuming that the answer to any of the foregoing three questions is in the negative, is there any other ground whereby the grant award to the Newark LEA may be supported, including possible designation of the Newark LEA as a district-wide Title I target area?*

New Jersey contends that "under regulations applicable in 1971 and consistent with the clearly expressed intent of Congress, the whole of the Newark school district could have been considered educationally disadvantaged so as to be a Title I area." Initial Br. p. 22, see pp. 22-28.

At the time of the Newark's submission of its 1971-72 application, 45 CFR § 116.17(d) provided in part:

> . . . In certain cases, the whole of a school district may be regarded as an area having a high concentration of [*children from low-income families*] and be approved as a project area, but only if there are no wide variances in the concentrations of such children among the several school attendance areas in the school district.

Newark did not apply under the above "no wide variance" rule to have the New Jersey SEA declare the entire Newark school district eligible for Title I services. Nor did New Jersey, when it approved Newark's 1971-72 application, determine that Newark qualified as a "no wide variance" district.

Nonetheless, New Jersey now contends, for the first time, that the Newark LEA was in fact so qualified. New Jersey first points to certain legislative history, relevant to Title I of the ESEA of 1965 and in particular to a 1965 Senate Committee Report which stated, inter alia: "There may be circumstances where a school system is basically a low-income area and the

best approach in meeting the needs of educationally deprived children would be to upgrade the regular program." Senate Rep. No. 146, 89th Cong., 1st Sess., reprinted in [1965] U.S. Code Cong. & News 1454. New Jersey next refers to a 1966 House Labor and Education Committee Report reaffirming this position:

> *"We specifically pointed that there may be circumstances where a whole school system is basically a low-income area and in which the best approach might be to upgrade the whole school system.* The first year programs involving a general upgrading of whole school systems were discouraged by the Office of Education. The construction of facilities to house Title I programs was permitted only sparingly. This restricted approach was necessitated by limited funds. In the next two years, especially in fiscal year 1968, more funds will be available and more children will be included in Title I programs. It is expected that more general upgrading of school systems and more construction will be permitted. *It is the feeling of the Committee that when 30 or 40 percent of the children in the district are from low-income families, all of the children in the district could be considered disadvantaged and the whole school system could be upgraded."* House Report No. 1814, 89th Cong., 2d Sess., reprinted in [1966] U.S. Code Cong. & Ad. News 3846 (emphasis added).

New Jersey claims that the district-wide low-income percentage for Newark for school year 1971-72 (33.9 percent) fits this model. Finally, New Jersey emphasizes that the narrative portion of the 1971-72 application shows Newark to have been uniformly disad-

vantaged in other important respects, citing high unemployment (14%), the highest percentage of slum housing in the nation, the highest incidents of crime, and the second highest birth rate. Also, in 1970-71 Newark had the highest population turnover in the nation, mobility rates reaching as high as 80 percent for schools in the Title I area. Hence, the Newark LEA had no choice but "to assume high concentrations of low-income families in all attendance areas and to attempt to spread the benefits of Title I as broadly as possible to assure that most educationally deprived children would be served." Initial Br. p. 25

The Deputy Commissioner answers New Jersey as follows:

1. Newark did not seek, under the "no wide variance" rule, to have the New Jersey SEA declare the entire Newark school district eligible for Title I services. Nor did New Jersey, when it approved Newark's application, make such a determination. Therefore it is irrelevant whether the Newark LEA could have qualified had it made such a request.

2. Even if the Newark LEA had made such a request in its 1971-72 project application, it clearly would not have qualified as a "no wide variance" district.

3. The "no wide variance" rule, 45 CFR 116.17(d), begins: "In certain cases the whole of a school district . . ." etc. "In certain cases" is left undefined, allowing LEAs to make these determinations by applying a reasonable standard of "no wide variance" subject to the approval of the SEA.

4. Since Newark's 1971-72 application shows a variance in low-income percentage from a high of 84.7 percent to a low of 10 percent, the Newark LEA's variance during the period in question was 74.7 per-

cent. Under no conceivable interpretation of the "no wide variance" rule could a variance of 74.7 percent be deemed acceptable. Hence, Newark never could have qualified.

5. With respect to the statement from the 1966 House Labor Committee report (on which New Jersey relies) that "when 30 or 40 percent of the children in the district are from low-income families all of the children in the district could be considered disadvantaged," such legislative statement has no relevancy to Newark's 1971-72 Title I project. Neither the Title I statute nor the Title I regulations at the time provided for such an exception and OE did not consider this single statement an adequate basis for issuing a new regulation or amending the "no wide variance" rule since it was inconsistent with the basic Title I policy of meeting the special educational needs of only educationally deprived children.*

Having carefully considered both New Jersey's arguments and the Deputy Commissioner's counterarguments, the Panel has concluded that under the then applicable regulations the whole of the Newark school district could not have been considered educationally disadvantaged so as to come within the "no wide variance" rule and so as to be designated a district-wide Title I target area.

III. *Summary*

Based on the foregoing recitals and the record made in this proceeding, it is the conclusion of the Panel

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* Since the Board is not authorized to determine whether the regulations are consistent with the statute and the expressed legislative intent, the Panel must apply the regulations on the assumption they are valid.

that New Jersey should make the following payments to the U.S. Office of Education:

1. $1,674 in Title I funds relating to items a. and b. of Enclosure No. 1 to the Deputy Commissioner's letter of June 11, 1976.

2. $1,029,630 in Title I funds relating to item c. of Enclosure No. 1 to the Deputy Commissioner's letter of June 11, 1976.

Pursuant to Sections 100e.81 and 100e.82 of the interim federal regulations establishing procedures for the Education Appeal Board (44 Fed. Reg. 30528, May 25, 1979), this Decision is transmitted to the Commissioner and to the parties, and each party is given notice that it may submit written comments thereon to the Commissioner within a period of twenty-five (25) calendar days from receipt of the Decision. This Decision shall become the final decision of the Commissioner unless, within sixty (60) days after the State of New Jersey's receipt of the Decision, the Commissioner modifies or sets aside the Decision.

ALOYSIUS B. MCCABE
ROBERT MILLER
FRANKLIN M. SCHULTZ
Education Appeal Board Panel

By /s/ Franklin M. Schultz
FRANKLIN M. SCHULTZ
Chairman

Dated: February 19, 1980

APPENDIX E

EDUCATION APPEAL BOARD
UNITED STATES OFFICE OF EDUCATION
DEPARTMENT OF HEALTH, EDUCATION AND WELFARE

DOCKET NO. 10-(25)-76
INITIAL DECISION
ACN: 50000-03

APPEAL OF:

THE COMMONWEALTH OF PENNSYLVANIA
TITLE I, ESEA

INITIAL DECISION

APPEARANCES: For the Commonwealth of Pennsylvania (the "SEA"): Patricia Donovan, Deputy Attorney General and Chief Counsel, Pennsylvania SEA; Margaret Hunting, Deputy Attorney General; Donna Weldon and Emogene Trexel, Assistant Attorneys General;

For the Albert Gallatin Area LEA: Carmen Molinaro, Jr. and Gerald Solomon, Counsel;

For the Philadelphia LEA: Martin Horowitz, Assistant General Counsel;

For the McKeesport LEA: Robert P. Costello, Solicitor;

For the Allentown LEA: William Malkames, Solicitor;

For the Pittsburgh LEA: Robert Stefanko, Counsel;

For the Deputy Commissioner of Elementary and Secondary Education, U.S. Office of Education, Department of Health, Education, and Welfare ("The Deputy Commissioner"): Philip Rosenfelt, Robert Arnot, Stephen Freid, and Janet Knight, Office of General Counsel, Education Division.

I. *Procedural History*

The early procedural history of this appeal is set forth in the Panel's "Pre-Hearing Conference Statement", issued February 18, 1977 and "Ruling on Pre-Hearing Motions", issued May 9, 1978.

Subsequently, the parties submitted prehearing briefs (November 22, 1978) and "Stipulations" identifying the expenditures in question and indicating some areas of agreement (April 19, 1979).

The SEA moved to sever the appeal into five separate proceedings. The motion to sever was denied by the Panel in a written order dated May 9, 1979, on the ground that severance of the five claims would not simplify the evidentiary stage of the appeal or otherwise contribute to the expedition and convenience with which the case could be heard.

On May 2, 1979, the parties submitted joint exhibits, most of which were subsequently introduced into evidence. Hearings were held in Pittsburgh on May 17 and 18, 1979, to take testimony on the audit exceptions for Albert Gallatin, McKeesport, and Pittsburgh, and in Philadelphia on May 24 and 25, 1979, to hear testimony relating to Philadelphia and Allentown and general testimony going to all the exceptions. Transcripts of these hearings are an integral part of the record.

The SEA filed a posthearing brief out of time, but with the leave of the Panel Chairman, on August 17, 1979.[1] The SEA filed proposed findings of fact and conclusions of law on September 6, 1979.

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[1] In a telephone conversation with the Panel Chairman, counsel for the SEA indicated that if the Panel would accept the SEA's post-hearing brief, and proposed findings of fact and conclusions of law out of time, the SEA would not plan to file a reply brief. The Panel agreed to late filing, without conditions.

On October 1, 1979, the Deputy Commissioner filed a post-hearing brief and proposed findings of fact.

On October 15, 1979, the SEA requested oral argument on the application of the statute of limitations and other issues. The Panel denied this request by order dated November 9, 1979, concluding that the issues had been fully aired and that further arguments would only serve to delay a decision.

After discussion with both parties, the Panel proposed to the parties a draft "Consent Judgment" as a means of resolving this appeal without a final adjudication by the Panel.[2]

On December 5, 1979, the Deputy Commissioner tentatively approved the "Consent Judgment" subject to approval by the Department of Justice. However, by letter dated December 14, 1979, the State declined the Consent Judgment approach.

The Panel therefore issues this Initial Decision herein.

II. *Amounts in Dispute*

Despite an original claim of $1,295,584.00, the amount in dispute was reduced by stipulation to $676,692.73, involving five LEA's as follows:

Albert Gallatin	$242,282.92
Philadelphia	93,146.86
McKeesport	275,651.45
Allentown	45,639.00
Pittsburgh	19,972.50
Total	$676,692.73

[2] Under the terms of the proposed "Consent Judgment", the SEA would have refunded $333,279.58 relating to the Philadelphia, McKeesport, Allentown, and Pittsburgh exceptions and the Deputy Commissioner would have relinquished claims to $331,427.63 relating to the Albert Gallatin and McKeesport LEA's.

In its posthearing brief, the SEA argued that the amount in dispute for the Pittsburgh LEA should be further reduced because three elementary schools found by the Deputy Commissioner to be ineligible to receive Title I funds were in fact eligible. The Deputy Commissioner concedes this point in his posthearing brief and has withdrawn his claim for refund with respect to the three schools.

The Panel agrees to a reduction of the amount in dispute for the Pittsburgh LEA from $19,972.50 to $7,986.98, leaving in dispute in this appeal $664,-707.21.

III. *Summary of Initial Decision*

For the reasons stated below, the Panel rules that the Albert Gallatin Title I program for fiscal years 1971 through 1973, was properly designed and implemented to meet the special educational needs of educationally deprived children; therefore the $242,282.92 at issue should not be refunded by the SEA.

With respect to the four other LEA's, the Panel concludes that the SEA has not carried its burden of proof and for the reasons set forth below, the audit exceptions are sustained and the SEA should refund the following amounts:

On the grounds of general aid

Philadelphia LEA	(FY 1971)	$ 93,146.86
McKeesport LEA	(FY 1971-73)	$275,651.45

On the grounds of ineligible schools [3]

Pittsburgh LEA	(FY 1971)	$ 7,986.98
Allentown LEA	(FY 1973)	$ 45,639.00
	TOTAL REFUND DUE	$422,424.29

[3] The Panel did not reach the ineligible schools issue in the McKeesport exception, having sustained the exception on other grounds.

IV. *Title I Requirements at Issue*

Basically there are two Title I requirements at issue in this appeal. One requirement is that Title I programs be designed to meet the special educational needs of educationally deprived children; the second requirement is that Title 1 projects served educationally deprived children residing in eligible attendance areas.[4]

A. *Design of Programs*

The Deputy Commissioner found that the Albert Gallatin, Philadelphia, and McKeesport LEA's were using Title I funds to provide general aid to entire schools. The audtit exceptions were based on three sections of the Title I regulations in effect in fiscal years 1971 through 1973. 45 C.F.R. 116.17(a) and (c) provided that Title I projects had to be designed specifically to meet the special educational needs of educationally deprived children. 45 C.F.R. 116.17(f) added that projects should have been designed to meet the special educational needs of those educationally deprived children who had the greatest need for assistance.

The specific prohibition against general aid was contained in § 116.17(g):

> Each such project must be tailored to contribute particularly toward meeting one or more of the special educational needs of educationally de-

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[4] Although the SEA argued that these Title I requirements are invalid, the Panel has no authority to waive them or rule on their validity. See § 7 of the *Federal Register* notice establishing the Title I Audit Hearing Board, 37 *Fed. Reg.* 23002 (1972), as amended 41 *Fed. Reg.* 28568 (1976), and § 100e.61 (b) of the interim final regulations establishing the Education Appeal Board. 44 *Fed. Reg.* 30523 (1978).

prived children and *should not be designed merely to meet the needs of schools or of the student body at large* in a school or in a specified grade in a school. (Emphasis Added)

In the Panel's judgment, the key question in determining whether an LEA violated the general aid prohibition is not whether entire schools or grades may have benefitted in some way from Title I funds, but whether the LEA properly designed and implemented its Title I programs to meet the special educational needs of educationally deprived children.

B. *Eligibility of School Attendance Areas*

The Deputy Commissioner found that the McKeesport, Allentown, and Pittsburgh LEA's used Title I money to fund projects in schools that were ineligible to receive Title I funds. The audit exceptions were based on the statutory mandate that Title I funds were to be used only for programs in school attendance areas having high concentrations of children from low-income families. 20 U.S.C. 241e(a)(1).

45 C.F.R. 116.17(d) set forth two basic tests for determining eligible attendance areas. The first test was whether the estimated *percentage* of children from low-income families residing in the school attendance areas was as high as the percentage of such children residing in the school district as a whole. The second test was whether the estimated *number* of children from low-income families residing in the school attendance area was as large as the average number of such children residing in the school district.

Under Section 116.17(d), an entire school district might be designated as eligible to receive Title I funds only if there were no wide variances in the concen-

trations of children from low-income families among the several school attendance areas that made up the school district.

Certain problems in the selection of eligible attendance areas arose where LEA's were undergoing desegregation: Two program guides by the Office of Education allowed an LEA that did not have well-defined attendance areas because of the implementation of a desegregation plan to determine which schools were eligible to receive Title I funds on the basis of the *percentage or number* of low-income children actually attending each school.[5] The schools selected still had to have percentages or numbers of low-income children equal to or greater than the percentage or number of low-income children in the district as a whole.

These program guides and a handbook on selecting target areas issued by the Office of Education[6] also allowed an LEA undergoing desegregation to "follow the child" with the Title I services. Under this concept, a child who resided in an eligible attendance area, but who attended a school serving an ineligible attendance area because of a desegregation plan, was eligible to participate in a Title I program.

(The Panel considers the Title I regulations and other guidance to be clear on the subject of selecting eligible attendance areas.) An LEA could choose between the "numbers" approach, the "percentage" approach, or, in limited circumstances, the "no wide variance" approach. In addition, an LEA could provide Title I services to specific groups of children

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[5] ESEA Title I Program Guides #44 (March 18, 1968) and #64 (January 21, 1971) (Hearing Exhibits 204 and 203).

[6] *ESEA Title I—Selecting Target Areas*, Handbook for Local Title I Officials (1971) (Hearing Exhibit 205).

who resided in eligible attendance areas but who, as the result of desegregation, attended schools that served ineligible attendance areas. The Panel finds no authority in the regulations or other guidance for an LEA to serve whole schools or grades in otherwise ineligible schools simply because some eligible children were bussed to such schools from eligible attendance areas.

V. *Discussion, Findings and Conclusions*

A. *Albert Gallatin—$242,282.92*

The Albert Gallatin LEA used Title I funds in fiscal years 1971 through 1973 to pay the salaries of elementary art, music, and physical education teachers, and also the salaries of librarians and library aides. In the opinion of the auditors from the HEW Audit Agency, these programs served all children in the Albert Gallatin elementary schools and were not designed, as required by Federal regulation, to serve only identified educationally deprived children. The Deputy Commissioner agreed with the HEW auditors, concluding that the Title I regulations in effect if fiscal years 1971 through 1973 clearly precluded the provision of services which met the needs of student bodies at large.

The SEA has not denied that these Title I-funded teachers and library personnel served all the children attending elementary schools in the Albert Gallatin school district. However, the SEA has offered testimony to establish that the whole school district was ecnomically depressed, that all children in the district had little or no access to library services and art or musical opportunities, and that a very high proportion of the children were educationally de-

prived as measured by standardized tests. (TR. pp. 14-35, 63-76 and 97-111)

On the basis of those facts, the SEA argues that the programs in question were not designed "merely" to meet the needs of a student body at large and that Section 116.17(g) did not prohibit a properly designed program from having some "spill-over" or incidental benefit to those portions of the school population that may not, strictly speaking, have been educationally deprived in these areas.

In support of its position, the SEA points to guidelines published by the Office of Education in 1966, numbered OE-35079 [7], which stated that where schools were severely depressed and overwhelmingly impacted by educationally deprived children from low-income families, some projects would tend to benefit all the children in a school whether educationally deprived or not.

The SEA also argues that the Albert Gallatin program was modeled in good faith after a Title I program in Kentucky that the Office of Education had touted as exemplary in its 1970 publication "Improving Education Through ESEA: 12 Stories." [8] Testimony establishes that the LEA relied heavily on this Kentucky program in designing its program. (TR. pp. 57-59.)

The Deputy Commissioner argues, on the other hand, that neither the economic or cultural depression of the area, nor the fact that some or even a majority of the students were educationally deprived, justified the use of Title I funds to serve all the children in the schools.

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[7] Hearing Exhibit 207.

[8] Hearing Exhibit 16.

In regard to the OE-35079 guidelines, the Deputy Commissioner makes three basic points: (1) there was no evidence that the LEA relied on OE-35079; (2) OE-35079 did not state that projects could be designed to provide direct services to entire student bodies; and (3) the Title I regulations were amended in 1967 to specifically prohibit the use of Title I funds to serve entire school populations.

As for "12 Stories," the Deputy Commissioner found nothing that authorized LEA's to ignore Title I requirements or to serve all children regardless of educational deprivation. The Deputy Commissioner also noted that "12 Stories" was prepared by an independent contractor and was not an official statement of program policy.

The issue for the Panel is not whether all children were served, but whether, in these circumstances, serving all the children violated the Title I prohibition against general aid. The Panel finds that it did not.

The facts support the LEA's determination that virtually all the elementary school children in the area were educationally deprived in the areas of art, music, physical education, and library resources. The Panel finds it particularly difficult to consider children with little or no access to libraries or opportunity to participate in cultural activities as being anything but deprived in those areas.

The Panel also finds some reliance on the description of the Kentucky program in "12 Stories" to be reasonable. The Office of Education simply cannot publish a booklet bearing its name and purporting to describe model Title I programs, and then turn around and argue that Title I planners should not have relied on the publication.

Finally, the Panel does not construe § 116.17(g) of the regulations as an *absolute* prohibition against programs serving all the children in a school. While a program may not be designed "merely" to meet the needs of a student body at large, a program can be properly designed and still, when implemented, benefit all such children.[9]

This is not to say that providing Title I services to all the children in a school is not frequently an indication of a general aid problem; it cannot, however, become absolute proof of improper design.

For the reasons stated above, the Panel rules that the SEA is not required to refund the $242,282.92 at issue for these services.

B. Philadelphia—$93,146.86

In fiscal year 1971, the Philadelphia LEA used Title I funds to provide library assistants and counselor aides to project area schools. The HEW auditors found that the library assistants' duties involved routine clerical and mechanical tasks associated with the overall operation of the libraries, and that the counselor aides provided clerical and rountine interviewing services for counselors. The auditors concluded and the Deputy Commissioner concurred that the services constituted general aid and were not directly related to the special educational needs of educationally deprived children.

The SEA maintains that the library assistants and counselor aides provided various direct and indirect services to Title I students according to their needs, stating in its posthearing brief that minority personnel hired with Title I money served children who

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[9] See also, Final Decision, *Appeal of the State of Mississippi*, Docket No. 1-(16)-76, July 8, 1978, pp. 22-5.

asked for help, obviously needed help, or were referred by classroom teachers who had made a judgment that the children needed help.

The SEA also argues that the OE-35079 guidelines justified a program serving all the children in schools which were overwhelmingly impacted by educationally deprived children from low-income families.

At the evidentiary hearing, an SEA official observed that counselor aides were the link between counselors and minority children, and made counseling services more efficient. He further observed that library assistants performed clerical duties so that librarians could work directly with the children, or actually provided services to the children. (TR, May 24, 1979, pp. 430-438.)

The SEA also brought out, through the cross-examination of an HEW auditor, statements by LEA personnel to the effect that counselor aides were only in the schools with the most serious economic and social problems, and that 70% of the educationally disadvantaged were in target schools being serviced by the library aide program. (TR, May 25, 1979, pp. 567, 570.)

The Deputy Commissioner's arguments with respect to the Title I regulations prohibiting general aid and the OE-35079 guidelines have been summarized in the context of the Albert Gallatin exception.

With respect to Philadelphia, the Deputy Commissioner also argues that the SEA failed to submit any evidence to rebut the audit determinations, and that the probability that some eligible educationally deprived children were served by the Title I-paid counselor aides and library assistants did not excuse the lack of program design.

An OE witness testified at the hearing that the LEA used local funds to pay the salaries of counselor aides and library assistants performing similar services in non-Title I schools (Tr. May 25, 1979, pp. 549-559) and that the services of the counselor aides and library assistants benefitted the Title I children only to the extent that they benefitted non-Title I children. (TR, May 25, 1979, p. 577)

As with the Albert Gallatin exception, the issue is whether the Title I services were designed to meet the special educational needs of educationally deprived children. Unlike Albert Gallatin, the Panel finds insufficient evidence that the Philadelphia LEA so designated the programs in question.

The evidence presented indicates that the Title I-funded counselor aides and library assistants provided general services to all the children in the schools, without distinction between eligible and ineligible students. The fact that some self-selection may have taken place, or that teachers may have steered a higher proportion of eligible than non-eligible children to these services, even if conclusively proved, would not substitute for proper design. And, even if the use of aides to free counselors and librarians from routine clerical duties was a valid use of Title I funds, there is no evidence that the freed time of the counselors and librarians was devoted to the special educational needs of Title I children.

The Panel finds that the SEA failed to carry its burden of proof on this exception. The SEA is required to refund the entire $93,146.86 at issue.

C. *McKeesport—$275,651.45*

OE seeks refund of $275,651.45 with respect to expendituures by the McKeesport LEA during Fiscal

Years 1971, 1972, and 1973. The questioned expenditures were for the salaries of three categories of LEA employees:

Curriculum Coordinators	$178,289.42
Library Personnel	59,592.42
Clerical Personnel	37,769.61

The auditors found that these expenditures constituted general aid in violation of the Title I statute and regulations, and OE seeks refund of these amounts on that basis. In addition, the auditors found that $50,815.00 of the same expenditures were spent at allegedly ineligible schools. Thus, recovery of that amount is sought on two separate grounds.

The Panel took considerable testimony with respect to the educational philosophy underlying the McKeesport program during the years in question and the specific duties and responsibilities of the three categories of LEA personnel to which the auditors take exception. The testimony of Dr. Harry Faulk, Superintendent of the McKeesport Schools during the years in question, was particularly eloquent in describing the special problems imposed on school administration by implementation of a major desegregation effort. Were the Panel's task to assess the soundness of the McKeesport desegregation effort, we would find much in the record of merit. Unfortunately, the Panel's task is to determine whether the Title I programs being challenged were both designed and executed in compliance with statutory and regulatory requirements. The Panel finds that they were not and concludes that the entire $275,651.45 must be refunded.

With respect to the curriculum coordinators, the evidence shows that their primary purpose and func-

tion was to ease the burden of integration by absorbing the many extra demands which desegregation placed upon the school districts, its teachers, its students, and their families—both minority and nonminority, both advantaged and disadvantaged. In addition, there is little dispute that their work was designed to enhance and improve the curriculum for entire schools, not for any particular grades or any particular group of students within the schools. (Tr., May 18, 1979, at 230, 252, and 277.)

The Panel does not interpret the general aid prohibitions of 45 CFR 116.17(a)(f) and (g) so broadly as to prohibit projects that will benefit a broader class of children than those identified as "educationally deprived". Indeed, the special circumstances of desegregation may require an approach to meeting the needs of educationally deprived children which has something more than incidental spill-over to those not so deprived. On the other hand, the Title I regulations are clear in requiring an element of specific design, "tailoring", or "targeting" on not only educationally deprived children, but within that class those with the greatest need for assistance. (116.17(a), (f), and (g)). The Panel is unable to find substantial evidence of such program design either in the original project applications, in any contemporaneous record keeping, or in the post hoc testimony taken in the course of this proceeding. In short, it is simply not sufficient to allege that the educationally disadvantaged child can best be served by improving the curriculum of the schools at large. While that may have been the prudent course in the particular circumstances of the McKeesport LEA during its desegregation efforts, it is a course that like most other worthwhile educational endeavors must be financed with

state and local funds, not with the categorical monies of Title I.[10]

With respect to the library personnel, the Panel finds little importance to the distinction between "learning resource centers" and "libraries", the subject of much testimony and debate throughout this proceeding. Again, the question is not whether the project was meritorious, nor whether the personnel in the learning resource centers functioned in much the same way that locally funded librarians functioned in other schools. The critical test for purposes of determining compliance with the Title I regulations is whether the program was sufficiently tailored to meet the particular needs of the educationally deprived. Again, while the educationally deprived may have derived substantial benefit from these personnel, there was no evidence to support a finding that the projects

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[10] The testimony of the McKeesport personnel displayed sufficient sensitivity to the needs of those students identified as slow learners to make it difficult to characterize the program as one which was designed "merely" to serve entire schools. The Panel is not prepared to find that the curriculum coordinators served no function other than those of ordinary school principals, even though there was contemporaneous evidence supporting that allegation. However, there is no evidence to support a contrary finding that the projects were sufficiently tailored so as to make an identifiable class of educationally deprived children the principle beneficiary. Given that dilemma, the Panel made every effort to enable the parties in this case to avail themselves of a settlement or consent judgment which would have allowed them to "split the apple" in such a fashion as to reduce the financial penalty assessed many years after the fact against a school district that, in admittedly difficult circumstances, failed to follow the letter of the law. Since the SEA declined to avail itself of that opportunity, the Panel has no choice but to apply the law and regulation to the facts as it finds * * *.

were tailored so as to serve primarily those eligible students.

With respect to clerical personnel, there is no dispute that they provided general clerical support to the curriculum coordinators and other school personnel whose functions served the schools at large. Nor is there any dispute that the Title I funded clerical persons devoted substantial effort to work on non-Title I matters. While the SEA asserted that the clerical personnel were necessary to offset an increased clerical workload resulting from the Title I program, there was no offer of proof on this point. The SEA further argues that any portion of this clerical budget devoted to non-Title I matters should be offset by Title I work done by locally funded clerical personnel; however, even if proved, there is no basis in law for extending such a credit in this audit proceeding. Title I funds may only be used for the purposes set forth in a project grant application. It is irrelevant to these proceedings whether or not the LEA might have been entitled to use Title I monies for personnel or projects not delineated in its grant application.[11]

Having sustained the full amount of the audit exception on the ground of general aid violations, the Panel need not reach the ineligible schools issue at McKeesport. While there are most certainly circumstances in which Title I monies can "follow the child"

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[11] For similar rulings by other Hearing Panels of the Board, see the final decisions in the *Appeal of the State of Texas*, Docket No. 7-(9)-74, February 10, 1978, p. 4, and the *Appeal of the State of Iowa*, Docket No. 3-(5)-74, December 7, 1977, pp. 11-12. In those decisions, the Panels held that Title I funds could be used only for programs described in applications for Title I funds that had been approved through the grant process.

in the desegregation situation, there would still have to be a showing that the funds were appropriately targeted to those specific students bussed from eligible attendance areas into otherwise ineligible receiving schools (thus overcoming the general aid prohibition). Given the relatively small percentage which the bussed children represented in the receiving schools, the burden of showing that the funds benefitted those children primarily, as opposed to the receiving schools at large, would be a serious one.

D. *Allentown—$45,639.00*

In its fiscal year 1972 and 1973 Title I applications, the Allentown LEA requested approval to provide reading services to 15 children in each of 15 ineligible schools. The children were to be residents of eligible attendance areas who were bussed to ineligible schools. The auditors found that although the SEA approved this application with the program limited to children residing in eligible attendance areas, in fiscal year 1973, only 34 of 236 students bused to the ineligible schools actually participated in the program. These 34 represented only 11.26 percent of the 302 children actually served by the program.

The Deputy Commissioner concluded that the LEA was not justified in serving the high number of children who attended ineligible schools and resided in ineligible attendance areas. Refund was demanded with respect to those children from ineligible attendance areas, but no refund is sought with respect to the 34 bussed children.

The parties have stipulated that the LEA's Title I application for fiscal year 1973 listed the percentages of children from low-income families in the various school attendance areas as ranging from 3 to 25%,

and that the SEA used an 8% variance factor to determine if an entire school district could be designated as a single project area under the "no wide variance" rule. The parties also agreed that under an order from the Pennsylvania Human Relations Commission, a desegregation plan was in effect in Allentown during fiscal year 1973. Under the plan, one school was closed, a second school was converted to a special education center, and the children who would have attended those schools were bussed to other schools in the LEA.[12]

The SEA does not dispute that of the 302 children who participated in the reading program in fiscal year 1973, only 34 were bussed into the schools under the desegregation plan.

The SEA argues that all schools in Allentown were eligible for Title I services, citing the desegregation order, OE directives on desegregation, and Federal and Pennsylvaia law barring discrimination on the basis of race as justification for its position. The SEA also argues that the LEA implemented a valid "follow the child" plan.

The Deputy Commissioner relies on the Title I regulations and other guidance to establish the two basic tests for selecting Title I-eligible school attendance areas, the "no wide variance" rule, and an LEA's limited authority to "follow the child". These basic tests and limited exceptions are discussed in III B. above.

The Deputy Commissioner argues that the 15 schools at issue were ineligible to receive Title I funds under both the percentage and number tests; that the entire LEA could not qualify as eligible under the

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[12] Stipulations, April 19, 1979, pp. 19-22.

"no wide variance" rule; and, finally, that there was no authority under which the LEA could designate all schools as eligible just because it was implementing a desegregation plan.

The Deputy Commissioner argues that the "follow the child" concept can support only the 34 children bussed from eligible attendance areas to ineligible schools (with respect to which no refund is claimed). Further, while a few children from ineligible attendance areas could properly have participated in the reading program to ensure integrated classes, it was not necessary to include 268 ineligible children to provide an integrated program for only 34 eligible children; a "follow the child" program still had to be designed and implemented to meet the needs of identified eligible children, not classes at large in the receiving schools.

As with McKeesport, the desegregation situation in Allentown undoubtedly posed special difficulties in implementing Title I. However, Allentown was not authorized by the Title I regulations, the Office of Education program guides, or the handbook on selecting target areas to designate all the schools in the district as eligible for Title I.

The only Title I provision which authorized designation of an entire school district as eligible was the "no wide variance" rule in Section 116.17(d) of the regulations. The Allentown LEA, with concentrations of children from low-income families ranging from 3 to 25% among the various school attendance areas, did not meet this "no wide variance" standard.

As for the "follow the child" rationale, the Panel is not convinced that the program was properly designed to focus on the children who were bussed from eligible school attendance into ineligible schools. Although it

may have been necessary to serve some small number of children from ineligible attendance areas to avoid resegregating the Title I children, the SEA has not shown that it was or could have been necessary to include 268 ineligible children to avoid segregating 34.

The Panel therefore rules that the SEA should refund the entire $45,639.00 at issue for this exception.

E. *Pittsburgh—$7,986.98*

Despite audit exceptions and a claim for refund initially involving twelve schools, the dispute with respect to Pittsburgh has subsequently been narrowed to six schools and $7,986.98, all in fiscal year 1971. With respect to five of the schools, the issue is whether they served attendance areas having the requisite concentration of children from low-income families. The sixth school was not among those listed on the LEA's Title I application to the SEA for the year in question.

The auditors found that the LEA funded Title I projects in five schools which, on the face of the LEA's application, had concentrations of low-income children below the district-wide average and were thus ineligible schools. The SEA asserts that despite the estimated concentrations of low-income children shown in Title I application, the LEA was nontheless entitled to declare these schools eligible on the basis of other available "data". A witness for the SEA testified that this latter information came from community action groups, the LEA's Title I advisory council, and teachers.[13]

The SEA further argues that the five schools served areas with high concentrations of children from low-income families, relying on a map of Pittsburgh

[13] Transcript, May 17, 1979, pp. 182-90.

indicating severely depressed areas of the city.[14] Several witnesses testified at length as to the geographic and demographic characteristics of the city, the preparation of the map by a local anti-poverty organization on the basis of census data, and the proximate location of the schools in question to the severely depressed areas indicated on the map.[15]

With respect to the sixth school, Arsenal Middle School, the SEA asserts that it was not included in the LEA's Title I application for fiscal year 1971 because it was not opened until late in the school year. The SEA also argues that the map of Pittsburgh prepared by the anti-poverty organization indicated that the school drew its student body from areas of high concentrations of low-income children, and that the school was eligible and funded by Title I in the following fiscal year.

With respect to the five schools, the Deputy Commissioner argues that a map prepared by a local anti-poverty organization indicating depressed areas had no relevance to the LEA's selection of schools for Title I. He points out that the anti-poverty organization did not define poverty areas in the same manner that LEA's were to select eligible school attendance areas under Title I regulations; that the map was not prepared for the use of the LEA; and that neither the LEA in selecting areas or the SEA in approving the selection relied on the map.

The Panel concludes that the five schools were improperly designated for 1971. The regulations and program guides clearly required an LEA to use percentages or numbers of low-income children as the

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[14] Hearing Exhibits 81 and 85.

[15] Transcript, May 17, 1979, pp. 141-180.

basis for its selection of eligible schools. The LEA's application indicated on its face that the five schools were not eligible on either a percentage or number basis.

The Panel finds no basis in law for reliance on the supplemental information brought forward after the fact and not even referenced on the original application. If special circumstances warranted a special interpretation of available data, that should have been disclosed to, and discussed with the SEA at the time of application.

As for the Arsenal Middle School, the Panel agrees with the Deputy Commissioner that the appropriate way to handle a school opening in mid-year is by amendment to the application, not unilateral action by the LEA. As noted at footnote 11 *supra*, Title I funds may only be used in the manner requested by the LEA in an application.

The SEA should refund the entire $7,986.98 remaining at issue.

VI. *Collateral Issues*

In its posthearing brief submitted August 17, 1979, the SEA raises a number of issues that do not bear directly on the merits of the individual audit exceptions. Several issues, specifically those involving Board authority, jurisdiction,and procedures, burden of proof, and availability of Government witnesses for cross-examination, were raised by the SEA in its prehearing motions. Since the Panel addressed those issues in its "Ruling on Pre-hearing Motions," dated May 9, 1978, we see no need to readdress those issues in this opinion.

The SEA also challenges the Panel's conduct of the evidentiary hearings. The SEA questions the Panel's

denial of an SEA motion to sever the appeal into five separate proceedings; a subsequent ruling establishing the order of testimony; and the admission of various evidence. The Panel considers all these questions to have been properly raised, ruled on, and preserved for the record during the course of the evidentiary hearings, and declines further comment thereon.

The SEA also argues that the Office of Education is estopped, through the publication of various conflicting documents, from pursuing these audit exceptions. However, the SEA has not established either substantial conflicts in the Office of Education publications or detrimental reliance on those publications. This is sufficient for the Panel to rule that the Office of Education is not estopped from seeking a refund in this case, without expressing an opinion as to what, if any circumstances might justify application of the estoppal doctrine against the Office of Education as a Federal agency.

Four further issues raised by the SEA, two in the form of motions to dismiss, are discussed briefly below.

1. *Conduct of the Audit*

The SEA argues that HEW's review of the SEA's administration of the Title I program was not a proper audit, claiming that the review was untimely, the auditors unqualified, and at least one auditor biased. Throughout the proceedings, the SEA has pointed to findings and statements in the auditors' workpapers, alleging them to be in error.

The Deputy Commissioner responds to these arguments by stating that the purpose of the appeal is to review his determinations, not the auditors' findings and recommendations. He points out that the SEA did not dispute the factual findings of the auditors

and maintains that the audit was conducted in a highly competent and professional manner.

The Panel does not believe that the Deputy Commissioner's determinations can be separated entirely from the basis for those determinations, the HEW auditors' findings as contained in the final audit report. While it is doubtful that the Panel's jurisdiction to review the Deputy Commissioner's final audit determinations would extend to a ruling on the propriety or impropriety of audit procedures, it is also obvious that serious errors on the part of the auditors would affect the validity of the Deputy Commissioner's determinations. However, the SEA was given ample opportunity through this appeal to prove the auditors and the Deputy Commissioner wrong. The Panel believes that the SEA's interests in a properly conducted audit were sufficiently protected by the forum provided through this appeal.

The Panel further finds that the alleged errors and misstatements in the auditors' workpapers, even if fully proven, were not so substantial or serious in nature that the validity of the entire audit report is thrown into question.

For the reasons given above, the SEA's motion to dismiss the audit exceptions on the basis of an improper audit is denied.

2. *Statute of Limitations*

The statute of limitations applicable to these audit exceptions reads as follows:

> No State or local educational agency shall be liable to refund any payment made to such agency under this Act (including Title I of this Act) which was subsequently determined to be

> unauthorized by law, if such payment was made more than five years before such agency received final written notice that such payment was unauthorized.[16]

Since the SEA received the final audit determination letter from the Deputy Commissioner on May 20, 1976, May 20, 1971 is the relevant cut-off date for applying the statute of limitations.[17]

In its posthearing brief, the SEA argues that the statute of limitations bars recovery of any "payment" made to the SEA prior to May 20, 1971. Since the SEA received its amended Title I payment for fiscal year 1971 on November 2, 1970, the SEA would make this the operative date.

The Deputy Commissioner, in response, relied on the "Stipulations" submitted by the parties on April 19, 1979. He maintained that by stipulating that $676,692.73 in Title I funds remained in dispute for the five exceptions, the parties had agreed that the statute of limitations did not bar recovery of the $676,692.73.

The Panel need not rely on the "Stipulations" to agree with the Deputy Commissioner that May 20, 1971, not November 2, 1970 is the operative date.

The word "payment" as used in the statute of limitations must be read in the context of the entire statute to effectuate its purpose. There is no direct relationship between the date money flows from the Federal government to the States and the time at

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[16] 20 U.S.C. § 3383 (Supp. 1979), formerly 20 U.S.C. § 804.

[17] See also Final Decision, *Appeal of the State of California*, Docket No. 6-(21)-76, August 21, 1978, pp. 8-9, and Final Decision, *Appeal of the State of Iowa*, Docket No. 3-(5)-74, December 7, 1977, pp. 13-14.

which expenditures at the State and local level can be characterized as "unauthorized". In the Panel's opinion, a payment becomes "unauthorized" only when funds are spent in violation of Title I requirements. Thus the Panel concludes that the date of expenditure should govern the application of the statute of limitations.[18]

The Panel notes that this interpretation is consistent with Congress' recent enactment of a statute of limitations for audit appeals coming before the Education Appeal Board. That statute provides that an SEA shall not be liable to refund an expenditure determined to be unauthorized by law if the expenditure was made more than five years before the SEA received written notice of the final audit determination.[19]

3. *Notice of Evidentiary Hearing*

Item 5 of the General Provisions establishing procedures for the Title I Audit Hearing Board, which were in effect in May 1979, at the time the evidentiary hearings in this appeal were conducted, provided that appropriate notice of generally not less than 25 days would be given in the *Federal Register* as to the time and place of such hearings.[20] The office

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[18] See Order on State of Oklahoma's "Supplemental Brief on Excessiveness of Refund Demand," *Appeal of the State of Oklahoma*, Docket No. 4-(34)-77, January 29, 1980, pp. 2-12, for a detailed discussion of the statute of limitations. See also Final Decision, *Appeal of the State of Iowa*, Docket No. 3-(5)-74, December 7, 1977, pp. 13-14 for a ruling that the date the SEA "drew down" Title I funds was irrelevant in gauging the reach of the statute of limitations.

[19] General Education Provisions Act, § 452(g), 20 U.S.C. 1234a(g) (Supp. 1979).

[20] General Provisions, Title I Audit Hearing Board, March 1, 1976.

of the Board, through an administrative error, failed to publish a notice of the hearings in the *Federal Register*.

The SEA argues that the audit exceptions should be dismissed on the ground the Board failed to observe its own procedures. The SEA also asserts that the Board failed to observe the provisions of the Government in the Sunshine Act.[21] In response, the Deputy Commissioner argued that the SEA was not harmed in any way by the Board's failure to publish notice of the hearings, and that the Government in the Sunshine Act was not applicable to Board proceedings.

The Panel finds that the SEA and the LEA's had actual notice of the time and place of the evidentiary hearings some two and one-half months before the hearings. The hearings were scheduled at times and places convenient to the SEA, the LEA's, and their witnesses. Since the SEA and LEA's had actual notice of the hearings, and the SEA had not alleged any harm resulting from the lack of notice, the Panel rules that the Board's failure to publish notice of the hearings does not amount to a procedural error serious enough to warrant dismissal.[22]

The Panel also finds that the Government in the Sunshine Act applies to agencies headed by collegial bodies.[23] Since the Education Appeal Board is part

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[21] 5 U.S.C. § 552b.

[22] A Notice of the appeal was published in the *Federal Register* prior to the pre-hearing conference. At that time, interested parties had an opportunity to intervene. Those that came forward were added to the formal service list in this appeal and thereafter received actual notice of all Board proceedings.

[23] 5 U.S.C. 552b.

of an agency headed by a Secretary rather than a collegial body, the Government in the Sunshine Act does not apply to Board proceedings.

The Panel denies the SEA's motion to dismiss the audit exceptions for failure to publish notice of the evidentiary hearings in the *Federal Register*.

4. *Petition to ReOpen the Record*

On February 25, 1980, the SEA petitioned this Panel to reopen the record in this appeal for the purpose of adding a letter dated July 31, 1975 from the Deputy Commissioner to the SEA. The letter concerned application of the statute of limitations to another, unrelated audit exception.

For the reasons set forth in the Deputy Commissioner's opposition dated February 29, 1980, the Panel declines to reopen the record at this late date.

VII. *Conclusion*

Based on the record compiled in this proceeding and consideration of the matters raised by the parties, the Panel concludes that the SEA should submit payment in the amount of $422,424.29 to the Department of Education.[24]

Under Section 100e.81 of the interim final regulations establishing procedures for the Education Appeal Board,[25] this decision will be transmitted to the Secretary of Education. Each party may submit written comments and recommendations on the decision to the Secretary within 25 calendar days of re-

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[24] The responsibilities of the Office and Commissioner of Education were formally transferred to the new Department and Secretary of Education respectively as of May 6, 1980.

[25] 44 *Fed. Reg.* 30528 (1979).

ceipt of this decision. This decision will become the final decision of the Secretary unless, within 60 calendar days of the SEA's receipt of this decision, the Secretary modifies or sets aside the decision.

Education Appeal Board

/s/ Robert J. Saner II
ROBERT J. SANER II
Chairman
DR. CHARLES E. HANSEN
OLCOTT D. SMITH, ESQUIRE

Date: May 7, 1980

APPENDIX F

[SEAL]

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
Office of Education
Washington, D.C. 20202

May 7, 1980

CERTIFIED MAIL
Honorable Fred G. Burke
Commissioner of Education
State Department of Education
Trenton, New Jersey 08625

Reference: Appeal of the State of New Jersey
Docket No. 14-(29)-76
Audit Control No. 50006-02

Dear Commissioner Burke:

A copy of the Panel's decision in the above-referenced appeal was sent to New Jersey on February 27, 1980, and received March 4, 1980. It is my duty to inform you that the Panel's decision, after the appropriate period for comment and review, now stands as the final decision of the U.S. Department of Education. In its decision, the Panel ruled that New Jersey should refund $1,031,304 to the Department of Education. Appropriate authorities within the Department will be in touch with you at an early date to discuss the method of repayment of the funds in question.

These proceedings before the Board now are closed.

Sincerely,

/s/ David S. Pollen
DAVIL S. POLLEN
Chairman
Education Appeal Board

cc: Dr. Thomas K. Minter, ED
Mr. William L. Ward, ED
Mr. Philip Rosenfelt, ED
Ms. Kathleen Duncan, New Jersey

[SEAL]

DEPARTMENT OF HEALTH, EDUCATION,
AND WELFARE
Office of Education
Washington, D.C. 20202

July 16, 1980

CERTIFIED MAIL
Honorable Robert G. Scanlon
Secretary of Education
State Department of Education
Harrisburg, Pennsylvania 17126

Reference: Appeal of the State of Pennsylvania
Docket No. 10-(25)-76
Audit Control No. 50000-03

Dear Secretary Scanlon:

A copy of the Panel's decision in the above-referenced appeal was sent to Pennsylvania on May 9, 1980, and received May 13, 1980. It is my duty to inform you that the Panel's decision, after the appropriate period for comment and review, now stands as the final decision of the U.S. Department of Education.

In its decision, the Panel ruled that Pennsylvania should refund $422,424.29 to the Department of Education. Appropriate authorities within the Department will be in touch with you at an early date to discuss the method of repayment of the funds in question.

These proceedings before the Board now are closed.

Sincerely,

/s/ David S. Pollen
DAVIL S. POLLEN
Chairman
Education Appeal Board

cc: Dr. Thomas K. Minter, ED
Mr. William L. Ward, ED
Mr. Philip Rosenfelt, ED
Ms. Emogene Trexel, Pennsylvania
Ms. Margaret Hunting, Pennsylvania
Mr. Gerald Solomon, Albert Gallatin
Mr. Martin Horowitz, Philadelphia
Mr. Robert Costello, McKeesport
Mr. Robert Stefanko, Pittsburgh

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